Industry Report on Small Business Loans in India

Five-Star Business Finance

November 2021

Table of Contents

Macroeconomic Scenario

COVID-19 pandemic impacts world and Indian economy; bounce back expected in fiscal 2022

According to the provisional estimates released by the NSO, India's real GDP growth in fiscal 2021 stood at -7.3% versus the earlier estimate of -8.0%. After sluggish growth in first half of the fiscal owing to rising Covid-19 cases, gross domestic product (GDP) growth has moved into positive territory in the second half of the year reflecting a pickup in economic activity.

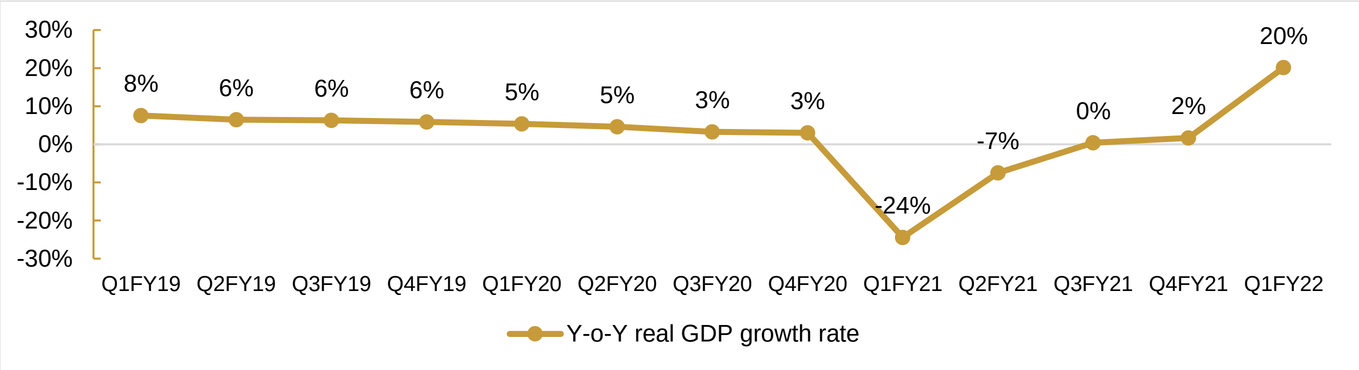
Fiscal 2020 was volatile for the global economy. The first three quarters were ensnared in trade protectionist policies and disputes among major trading partners, volatile commodity and energy prices, and economic uncertainties arising from Brexit. Hopes of broad-based recovery in the fourth quarter were dashed by the Covid-19 pandemic, which has infected more than 227 million people in 224 countries (as of September 17, 2021), leading to considerable human suffering and economic disruption.

The COVID-19 pandemic sharply slowed the Indian economy in the first quarter of Fiscal 2021, but the huge economic costs that it extracted, forced the economy to open up and get back on its feet in the second quarter of Fiscal 2021. What also helped was a sharp cutback in operating costs for corporates due to job and salary cuts, employees exercising work from home options, low input costs due to benign interest rates, crude and commodity prices..

The fierce second wave of Covid-19 pandemic took the healthcare ecosystem to the brink and beyond in Q1 of fiscal 2022, but it did not hit economic activity as hard as the first wave did. The main reason for this would be decentralised and less-stringent lockdowns, which reflect the 'learning to live with the virus attitude' that authorities adopted. Many states also permitted construction and manufacturing activities to continue during the lockdown.

The pandemic came at the most inopportune time since India was showing signs of recovery following a slew of fiscal/monetary measures as nominal GDP grew by 8.8% on year in Q4 of fiscal 2021 as compared to 4.7% in Q4 of fiscal 2020. Having said that, CRISIL Research foresees growth rebounding in Fiscal 2022, on the back of a very weak base, a counter-cyclical Union Budget for Fiscal 2022 pushing investments and some benefit from a rising-global-tide-lifting-all-boats effect. The gradual increase in vaccinations against COVID-19 is also expected to boost confidence and support stronger recovery. Even after the strong rebound, fiscal 2022 real GDP is expected to be only slightly higher than that in fiscal 2020.

Trend in real GDP growth rate on quarterly basis

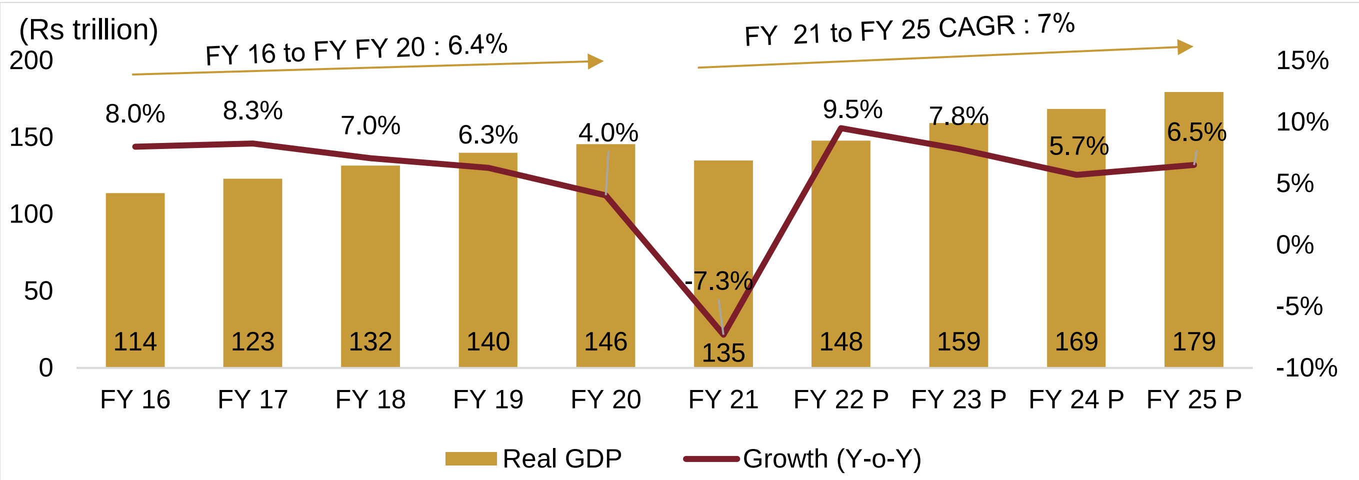


Source: CSO, RBI, CRISIL Research

The budget's focus on pushing capital expenditure (capex) despite walking a fiscal tightrope however provides optimism and creates a platform for higher growth. Given that the focus of the budget was on investment rather than consumption push, the full impact of the expenditure will be seen in the near term via multiplier effects, and over time, through enhancement of productive capacity. To that extent, CRISIL Research believes that the budgetary provisions help raise the medium-term prospects for the economy.

This budget not only focussed on pushing central capex but also attempted to nudge state government capex. A Reserve Bank of India (RBI) study points out that an increase in capex by the central and state governments by one rupee each induces an increase in output by Rs 3.25 and Rs 2.0, respectively *(Source: RBI Bulletin – April 2019).*

Budgetary support and vaccines expected to boost economic growth



Note: P - Projected

Source: National Statistics Office (NSO), International Monetary Fund (IMF) and CRISIL Research estimates

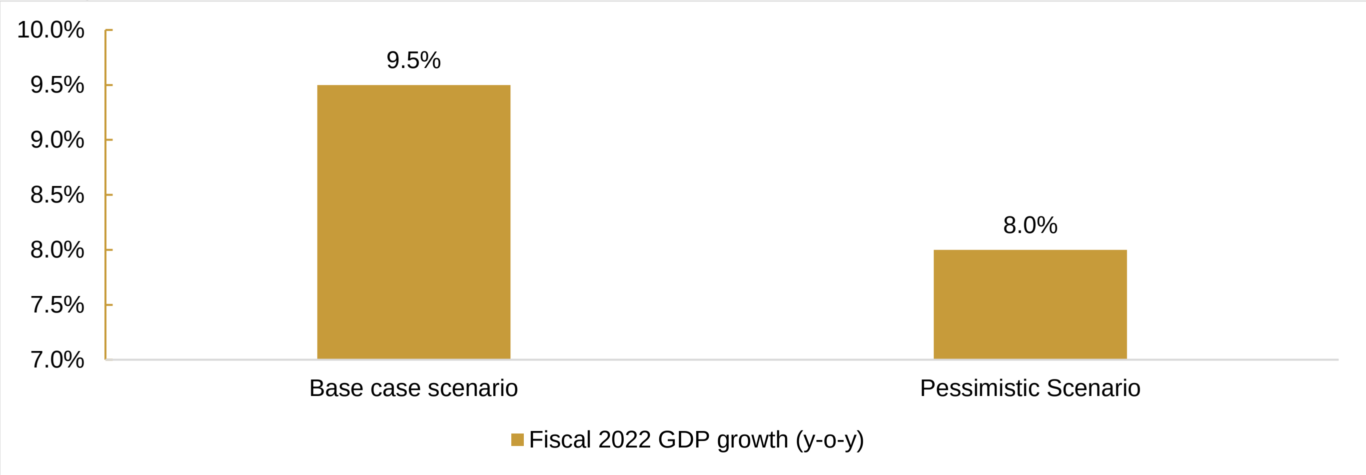
The possibility of a third Covid wave post the festive season does pose a downside risk to economic growth in fiscal 2022. In the aftermath of the second wave witnessed in the first quarter of the fiscal, many states had implemented localised restrictions in the form of weekend lockdowns, restricting non-essential businesses from operating and/or night curfews to prevent the spread of the infection. Although the Covid cases during 2nd wave have declined to below 40,000 in mid-July 2021 from over 4 lakh cases in 5th May 2021, there is still the looming fear of a third wave.

CRISIL Research forecasts India's GDP for fiscal 2022 to grow by around 9.5% in our base case scenario, assuming that 70% of the adult population will be vaccinated by December 2021 and a third Covid wave does not strike us.

Covid-19 vaccinations have also started gaining pace in India. While close to 64% of India's adult population has received the first dose of the Covid-19 vaccine (as of September 19, 2021), 21% of India's adult population has taken the second dose.

A third wave would pose a significant downside risk to the growth forecast, as would a slower-than-anticipated pace of vaccination. We forecast India's GDP to grow by 8% in fiscal 2022 in our pessimistic scenario.

GDP growth scenarios based on assumptions of case peak

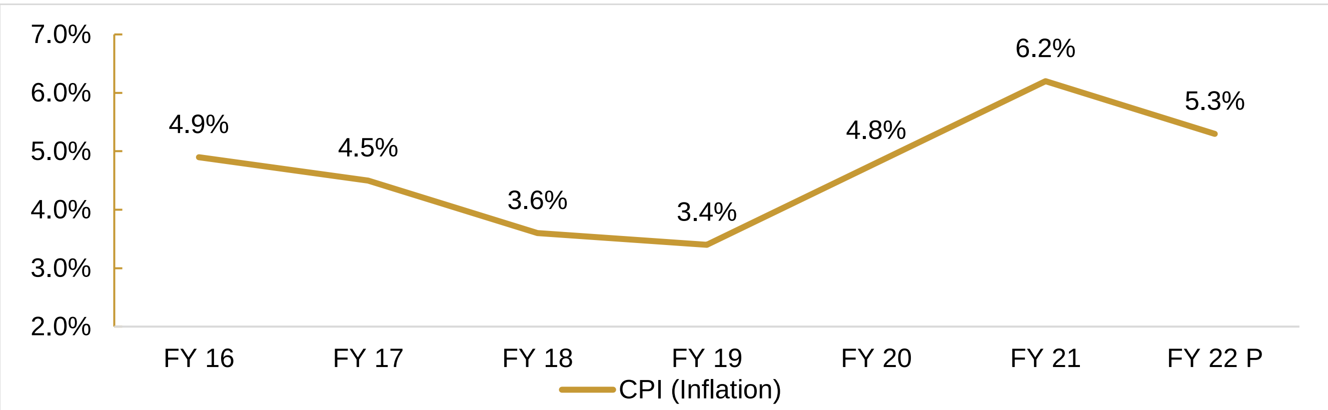


Source: CRISIL Research

In fiscal 2023, CRISIL Research expects growth to remain strong at 7.8% and become more broad-based, as a sufficient proportion of population gets vaccinated by then. This will particularly strengthen growth for contact-based services, which have been the biggest victims. Beyond that, growth is expected to moderate.

Prior to the onset of the pandemic, India's GDP growth slowed on account of existing vulnerabilities such as a weak financial sector and subdued private investment. However, in light of production-linked incentive (PLI) scheme, reduction in corporate tax rate, labour law reforms together with healthy demographics and a more favourable corporate tax regime, India is expected to witness strong GDP growth when the global economy eventually recovers, supported by prudent fiscal and monetary policy.

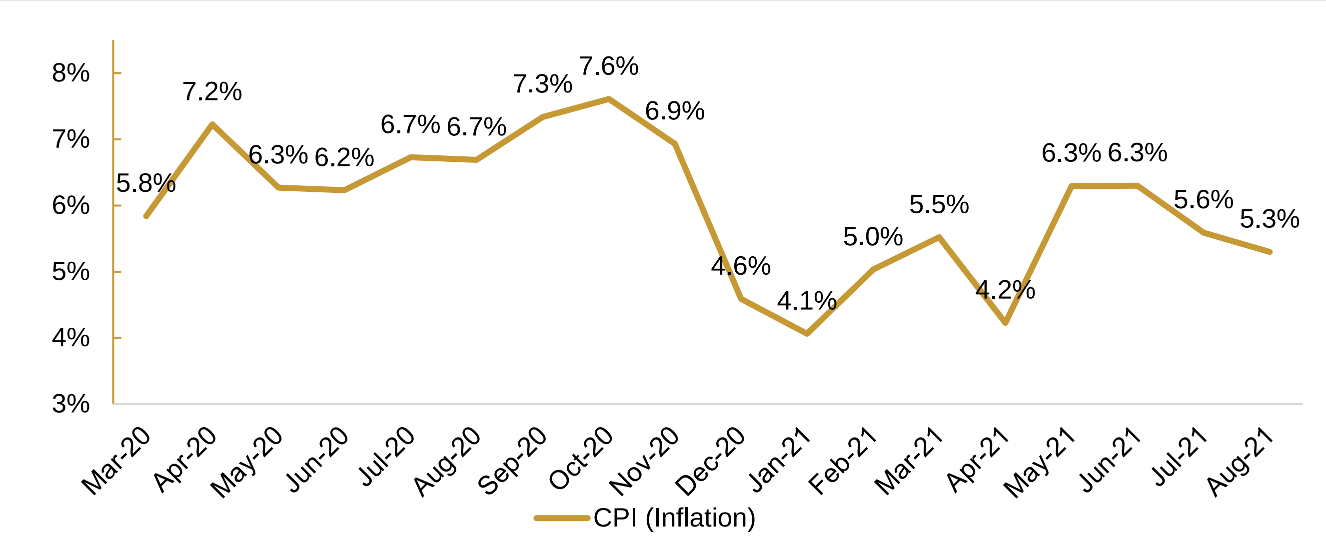
Due to higher liquidity push, inflation moved out of target band



Note: P - Projected

Source: National Statistics Office (NSO) and CRISIL Research

CPI inflation has been on the higher side in recent years



Source: National Statistics Office (NSO) and CRISIL

CPI Inflation was out of RBI's target band of 2-6% from April 2020 to November 2020; however, it remained within RBI's target band from December 2020 to April 2021. In May 2021 and June 2021, the inflation levels observed slight elevation and were out of RBIs target band; however, in July 2021 and August 2021, CPI inflation declined to 5.6% and 5.3%, respectively.

Inflation continues to face pressure from high international commodity prices, including edible oils and metals, which are at decadal highs and crude oil prices which remain beyond the comfort zone at over ~$70 per barrel. Recent data has indicated firms passing on rising input costs to consumers despite weak demand conditions. We expect the pass-through to gain more steam as domestic demand strengthens in the second half of this fiscal.

The lid on overall inflation will be kept by food, as it benefits from the high base of last year. However, the progress of monsoon and impact of rising global food prices will remain a key monitorable. CRISIL pegs fiscal 2022 average CPI inflation at 5.3% for fiscal 2022.

Macroeconomic outlook for Fiscal 2022

Macro variables	FY20	FY21E	FY22P	Rationale for outlook
GDP (y-o-y)	4.0%	-7.3%	9.5%*	The second wave and the resultant localised lockdowns has impeded the path to economic recovery, leading CRISIL to revise down the growth forecast for Fiscal 2022 to 9.5%, from 11.0% earlier. That said, expected pick-up in economic activity post-vaccination and support from global growth would act as positives
Consumer price index (CPI) inflation (y-o-y)	4.8%	6.2%	5.3%	Upside risks on inflation are growing from surging international commodity prices. While producers are bearing a greater burden of rising input costs for now, these could get passed to retail prices once demand recovers. Food inflation could also face pressure from disruptions to the rural economy due to the pandemic's spread, and rising global prices
10-year Government	6.2%	6.2%	6.5%	The RBI's unconventional policy measures have been instrumental in keeping G-sec yields at decadal lows, at a time when the bond market is

security yield (March-end)				facing an unprecedented rise in Government borrowing. Supply pressures could have a bearing on yields once the RBI starts normalising liquidity. Adverse global developments such as premature withdrawal of monetary easing by US Federal Reserve could further add pressure
CAD (Current account balance)/GDP (%)	-0.9%	1.3%	-1.2%	The trajectory of COVID-19 infections, pace of the vaccination drive, and duration of state lockdowns will have an important bearing on domestic demand and, consequently, import growth. Increased prices of commodities, especially crude oil – India's largest import item – will drive imports. External demand will support exports, backed by strong economic recovery among India's major trading partners in the US, Europe, and Asia
Rs/$ (March average)	74.4	72.8	75.0	With the second wave adversely impacting India's economic recovery, and amid inflationary pressures, the rupee may weaken against the dollar. The current account balance turning into deficit (from a surplus last Fiscal), will exert further downside pressure on the rupee. Some support may be seen due to the RBI's interventions to mitigate volatility. Record high forex reserves and foreign investor inflows, owing to interest rate differential between India and global economies, will also prop up the rupee

**Downward bias*
Note: P – Projected
Source: Reserve Bank of India (RBI), National Statistics Office (NSO), CRISIL Research

GDP to bounce back over the medium term

After clawing back in fiscal 2022, CRISIL Research forecasts India's GDP to grow at 6.0-7.0% per annum between fiscals 2023 and 2025. This growth will be supported by the following factors:

- Focus on investments rather than consumption push enhancing the productive capacity of the economy.
- The production linked incentive (PLI) scheme which aims to incentivise local manufacturing by giving volume-linked incentives to manufacturers in specified sectors
- Raft of reform measures by the government along with a more expansionary stance of monetary policy leading to a steady pick-up in consumption demand
- Policies aimed towards greater formalisation of the economy are bound to lead to an acceleration in per capita income growth

Risks to growth

Covid-19 cases increasing, a third wave this fiscal: The second Covid-19 wave has thrown cold water over the Indian economy that was beginning to warm up after the most severe contraction since Independence. The rash of afflictions that followed forced states to lock down, hurting consumer and business confidence yet again. Mercifully, daily cases seem to have peaked for now, though they remain above the peak of the first wave. But the risks of another wave and tardy vaccinations mean states would be chary of fully unlocking anytime soon. It can have a debilitating impact on economic activity and thereby growth.

Elevated inflation: Significant cost-push pressures on account of surging international commodity prices and supply disruptions has raised cost of production for manufacturing firms. Pass-through to consumer prices could further pose as a headwind to recovery in demand.

Premature tightening of global monetary policies: Resurgence of inflation globally could lead major central banks to unwind their extraordinary easy monetary policies sooner than expected. This could hit sentiment, possibly leading to capital outflows from the Indian economy and some tightening in domestic financial conditions.

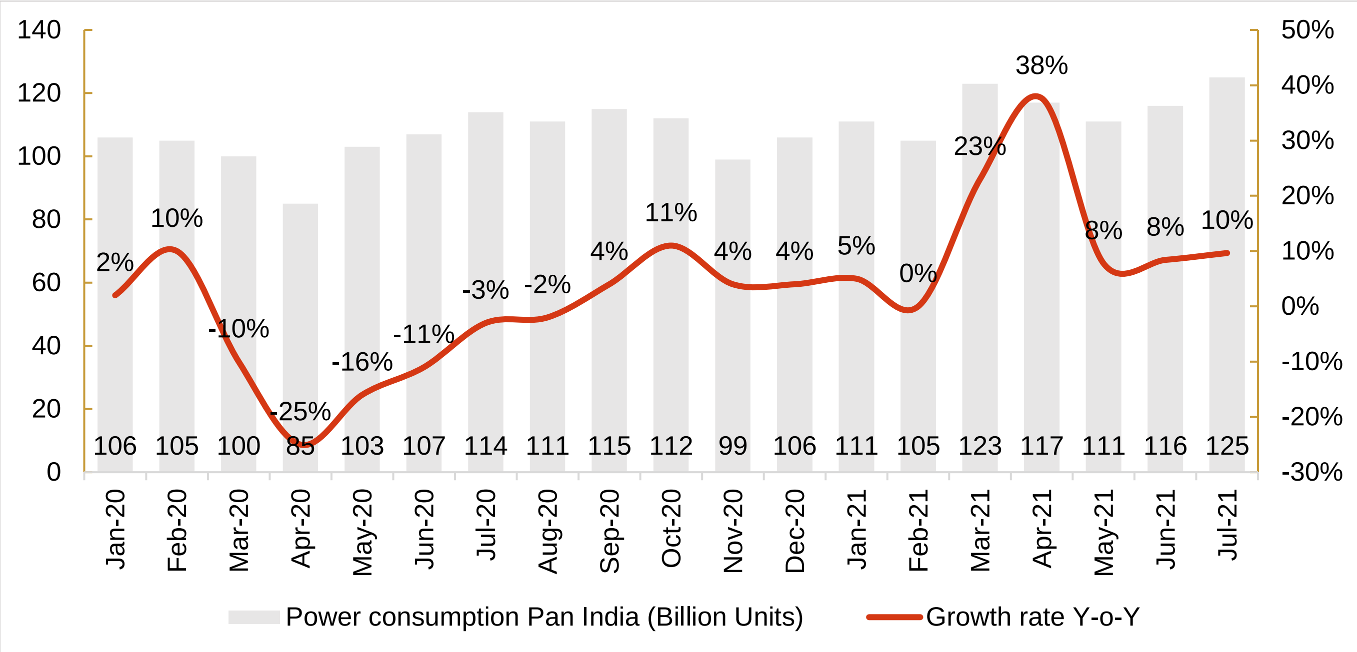
Geopolitical developments: External developments, most importantly the US-China trade war, have proved to significantly impact global GDP growth as well as export earnings and capital flows to emerging markets such as India. While there is some respite with the signing of Phase 1 of the US-China trade deal, several issues remain unresolved. Any re-escalation of tensions could again work adversely. Geopolitical developments in the Middle East could also disrupt crude oil supply and prices, likely hurting a wide range of domestic macroeconomic parameters, including current account deficit, inflation and GDP growth.

Persistent stress in financial sector: This has been one of the major drags on GDP growth. Liquidity issues faced by NBFCs and risk aversion amongst lenders has hampered credit growth as well as transmission of monetary policy easing. While credit growth is expected to improve in the current fiscal with stronger GDP growth, the system is expected to continue to face uncertainty over asset quality with the Covid-19 pandemic continuing to cast its shadow on the economy. Easing of constraints and risk aversion in the financial system is critical for pick-up in growth.

Pick up in power demand in many states

Power consumption in India was impacted in the months of lockdown during the first wave of the pandemic in fiscal 2021. Power demand recovered in September 2020 and growth in power demand has been positive in most months after that. The growth in power demand indicates continuity in industrial activity, especially manufacturing. The trend in Purchasing Manufacturing Index also indicates that manufacturing activity has remained resilient even during the second wave.

Monthly trend for power consumption in India



Source: POSOCO, CRISIL Research

Most states in India have started recovering from Covid-19 which is indicated by rise in power demand. In the months of April to July 2021, cumulative power demand witnessed a growth of 15% over the same period last year at a pan-India level. Among top ten states, Gujarat and Maharashtra witnessed higher growth than that at a pan-India level.

Power demand in states across India

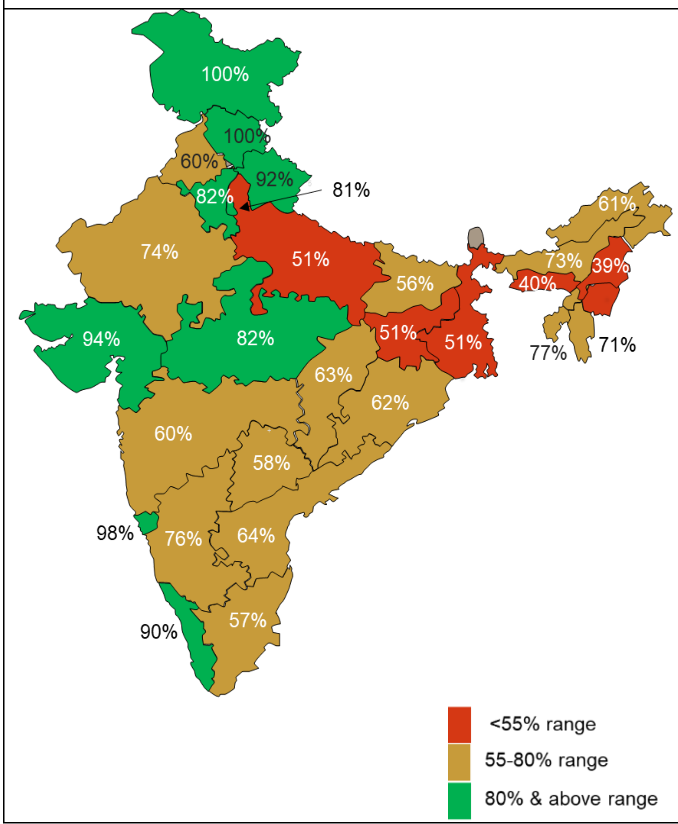
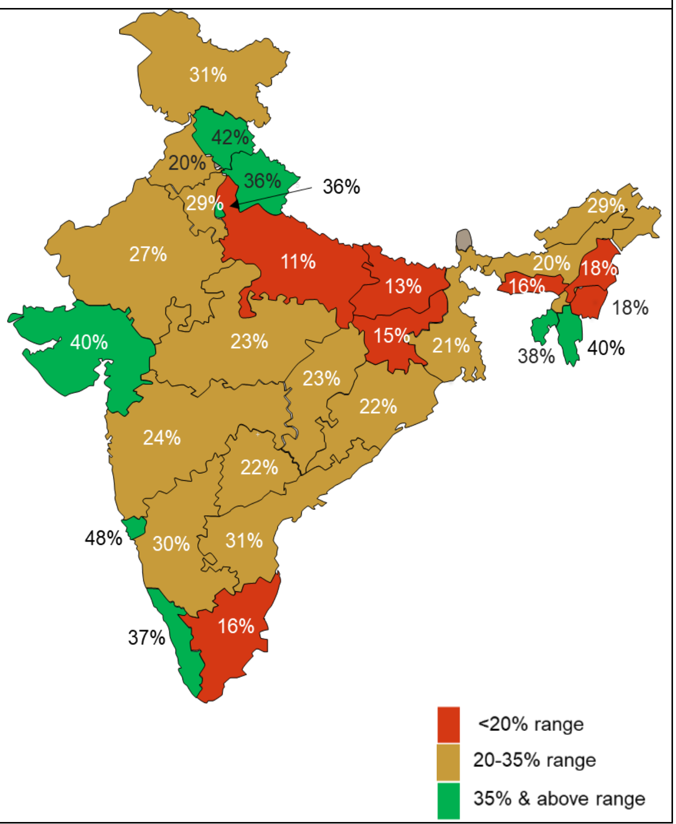
State and UTs	Share in power demand	April to July 2021 - YoY growth
Maharashtra	12.3%	21%
Uttar Pradesh	9.7%	9%
Gujarat	9.2%	23%
Tamil Nadu	8.3%	13%
Rajasthan	6.7%	7%
Madhya Pradesh	6.7%	9%
Karnataka	5.6%	4%
Telangana	5.3%	13%
Andhra Pradesh	5.0%	12%
Punjab	4.6%	14%
Haryana	4.2%	16%
West Bengal	4.2%	17%
Bihar	2.7%	16%
Chhattisgarh	2.4%	15%
Delhi	2.4%	10%
Odisha	2.3%	29%
Kerala	2.0%	4%
J&K	1.4%	13%
Uttarakhand	1.0%	22%

Himachal Pradesh	0.8%	28%
Jharkhand	0.8%	11%
Assam	0.7%	65%
DNH	0.4%	97%
Goa	0.3%	28%
Pondicherry	0.2%	20%
Tripura	0.2%	9%
D&D	0.2%	65%
Meghalaya	0.1%	34%
Chandigarh	0.1%	12%
Manipur	0.1%	68%
Nagaland	0.1%	56%
Arunachal Pradesh	0.0%	102%
Sikkim	0.0%	11%
Mizoram	0.0%	51%
All India Power demand CY 2020 (billion Units)	1,262	15%

Source: POSOCO, CRISIL Research

Covid-19 vaccinations have also started gaining pace in India. While close to 65% of India's adult population has received the first dose of the Covid-19 vaccine (as of September 21, 2021), 22% of India's adult population has taken the second dose.

State wise extent of vaccination

India's 65% adult population has taken 1st dose	**India's 22% adult population if fully vaccinated**
	

Note: Figures as on 21st September
Source: GOI data, CRISIL Research,

India's GDP to recover sharply

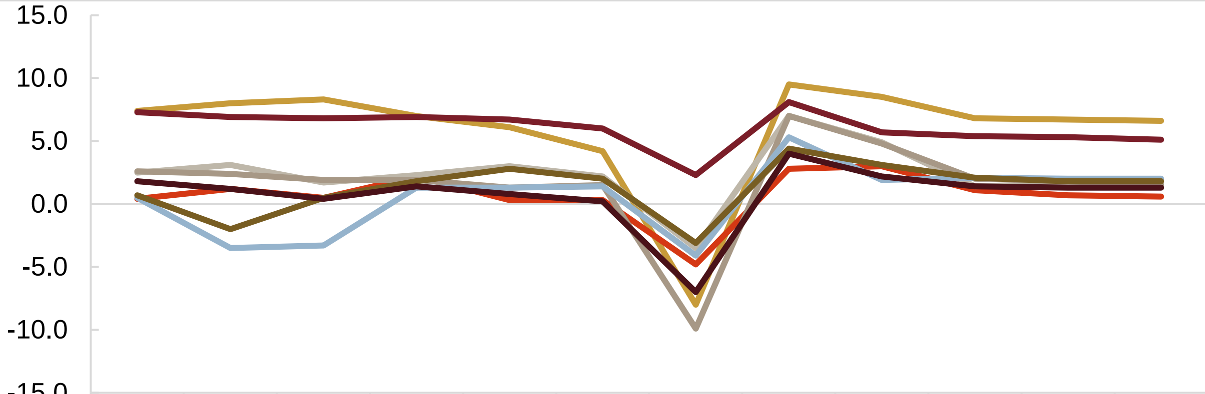
India was one of the fastest growing economies in the world pre-COVID, with annual growth of around 6.7% in between calendar year 2014 to 2019. Over the few years prior to the onset of the pandemic, India's macroeconomic situation had gradually improved with the twin deficits (current account and Fiscal) narrowing and the growth-inflation mix improving and durably so. The Government adopted an inflation-targeting framework that provides an institutional mechanism for inflation control, while modernising central banking.

While economic growth in calendar year 2020 has been dented due to COVID-19, CRISIL expects the economy to rebound and India to regain its tag of one of the fastest growing economies globally in the medium-term.

Going forward, rapid urbanisation, rising consumer aspiration and increasing digitisation coupled with government support in the form of reforms and policies is expected to support growth. For example, the government has recently announced production-linked incentives across identified sectors with an aim to propel the growth of India as a manufacturing destination. At a macro level, digitalization has led to various benefits like linkage to Aadhaar identity cards, direct benefit transfer and various other government benefits.

The IMF forecasts India's GDP to grow by 9.5% in calendar year 2021 due to the lower base of calendar year 2020 and approved vaccines and policy measures. At this pace of growth, India is forecasted to be the fastest growing economies in the world in 2021. Going forward as well, IMF forecasts India's GDP to grow at a faster pace than other economies.

India is one of the fastest-growing major economies (GDP growth, % year-on-year)



	2014	2015	2016	2017	2018	2019	2020	2021	2022 P	2023 P	2024 P	2025 P
India	7.4	8.0	8.3	7.0	6.1	4.2	-8.0	9.5	8.5	6.8	6.7	6.6
China	7.3	6.9	6.8	6.9	6.7	6.0	2.3	8.1	5.7	5.4	5.3	5.1
Japan	0.4	1.2	0.5	2.2	0.3	0.3	-4.8	2.8	3.0	1.1	0.7	0.6
United states	2.5	3.1	1.7	2.3	3.0	2.2	-3.5	7.0	4.9	1.4	1.5	1.6
United kingdom	2.6	2.4	1.9	1.9	1.3	1.5	-9.9	7.0	4.8	2.0	1.8	1.5
Brazil	0.5	-3.5	-3.3	1.3	1.3	1.4	-4.1	5.3	1.9	2.1	2.0	2.0
Russia	0.7	-2.0	0.5	1.8	2.8	2.0	-3.1	4.4	3.1	2.1	1.8	1.8
South Africa	1.8	1.2	0.4	1.4	0.8	0.2	-7.0	4.0	2.2	1.4	1.3	1.3

Note: GDP growth is based on constant prices, Data represented is for calendar years, P: Projected

Source: IMF (World Economic Outlook – July 2021 and April 2021 update), CRISIL Research

Along with being one of the fastest growing economy in the world, India ranks fifth in the world in terms of nominal GDP in calendar year 2020. In terms of purchasing power parity (PPP), India is the third largest economy in the world, only after China and the United States.

GDP Ranking of key economies across the world (2020)

Country	GDP Rank	% share (World GDP)	PPP Rank	% share (World GDP,PPP)
United States	1	24.7%	2	15.8%
China	2	17.4%	1	18.3%
Germany	3	4.5%	4	3.4%
United Kingdom	4	3.2%	9	2.3%
India	5	3.1%	3	6.7%
France	6	3.1%	8	2.3%
Italy	7	2.2%	10	1.9%
Canada	8	1.9%	14	1.4%
Korea	9	1.9%	13	1.7%
Russia	10	1.8%	5	3.1%

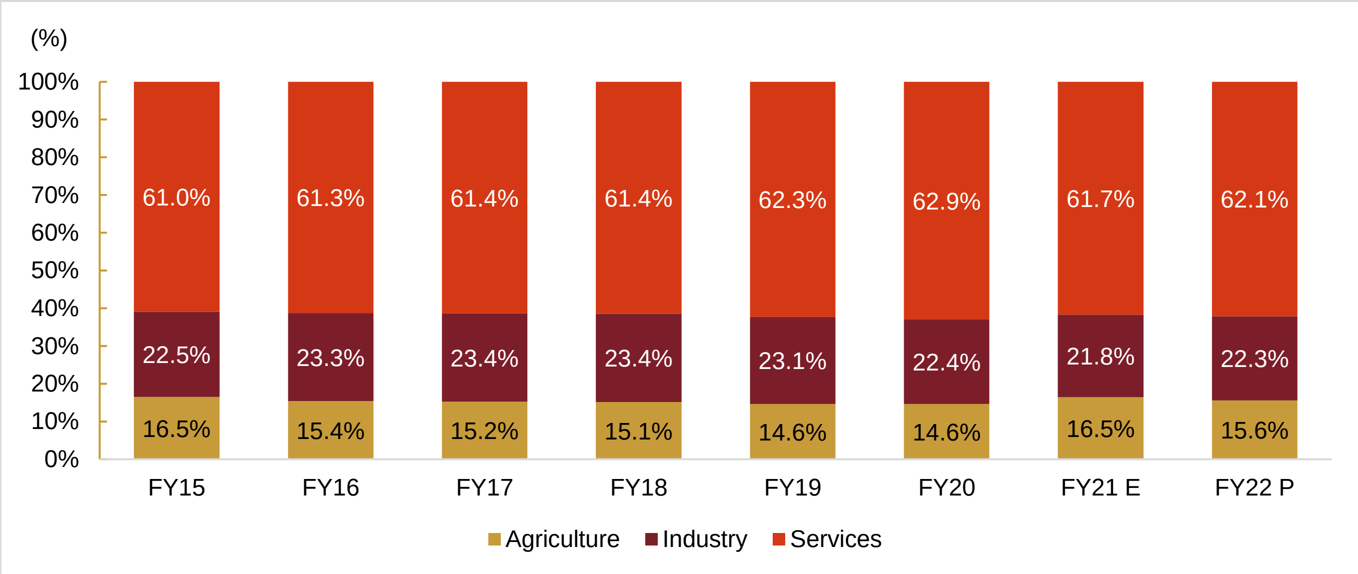
Note: Japan is not considered in the key economies as data for 2020 is not available

Source: World Bank, CRISIL Research

Contribution of various sectors to GDP

As compared to various developed economies, which witnessed a good contribution from manufacturing and industry first and subsequently in services, the Indian transformation story has been different. A notable feature of Indian economy has been the services sector's rising contribution to the overall output of the economy. Over the last three fiscal years ending fiscal 2020, the service sector has grown at a rate of ~7%, thereby taking the contribution of services sector to 62.9% in terms of Gross Value Added (GVA) at constant prices. In fiscal 2021, overall GVA contracted by ~6.5% with industry and services sector contracting by ~7.4% and ~8.4% respectively.

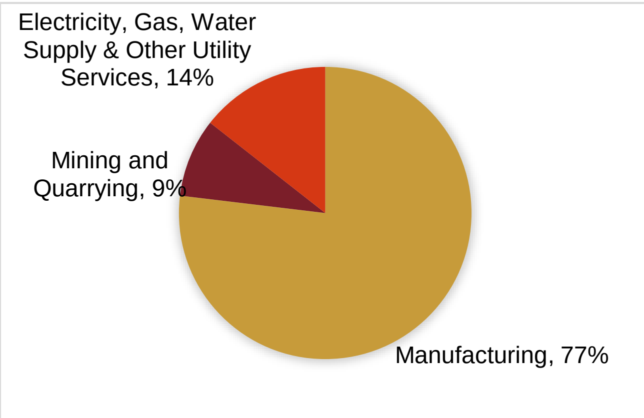
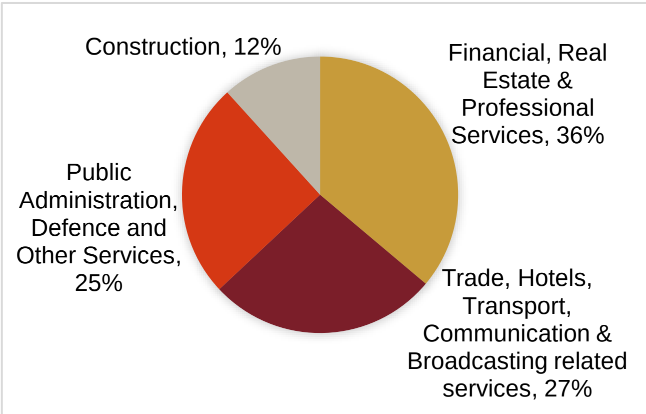
Share of sector in GVA at constant prices



Note: E – Estimated, P - Projected

Source: RBI; CRISIL Research

Industry and services sector can be further classified into sub-sectors. In industry, majority of the contribution comes from manufacturing sector which contracted by ~5% and in the services sectors, highest contribution comes from financial, real estate and professional services segment which witnessed a muted growth of ~1%. Within services sector - Trade, Hotels, Transport, Communication and Services related to broadcasting was severely hit as it witnessed a contraction of ~15% followed by construction which contracted by ~6% in fiscal 2021.

Share of sub-sectors in GVA by Industry (FY21)	Share of sub-sectors in GVA by Services (FY21)
	

Source: RBI, CRISIL Research

Budget turns expansionary with an eye on medium term

India's first union budget after a once-in-a-century global pandemic -- and only the fourth to follow a contraction in its independent history – voted for an infrastructure-led, counter-cyclical Fiscal stimulus to mend the broken economy. The idea clearly, was to push the growth multiplier rather than stoke consumption through steroids, even if that meant stretching the glide path of Fiscal deficit. If there is an overarching picture, it is that this budget sets the tone for much-needed infrastructure growth for the next 3-4 years. That will help both, sustain development and create jobs. But implementation, which is all-crucial, remains the elephant in the room.

Broadly, the budget had five key highlights:

- **Growth-focussed, expansionary**

Significantly, it chose to push the pedal on investment at this juncture. Studies highlight how the positive spill over effects of public investment only amplify during periods of uncertainty. For the Indian economy specifically, capital expenditure (capex) typically has higher multiplier effect than revenue spending, by crowding in private investment. This budget not only focussed on pushing central capex but also attempted to nudge state Government capex. A Reserve Bank of India (RBI) study points that an increase in capex by the central and state Governments by one rupee each induces an increase in output by Rs. 3.25 and Rs. 2.0, respectively.

- **Improved spending quality**

While maintaining focus on capex, the budget also allowed for some normalisation of extraordinary spending that took place in response to the pandemic. That said, it also attempts to improve quality of spends (compared with the pre-pandemic trend). Thus, Government has not only chosen to re-orient expenditure but also has tried to improve the expenditure mix to make way for more capex.

- **Enhanced transparency**

Deficit numbers have shot up. But one reason for this is enhanced transparency in the budget, which lends to their credibility. The budget relies less on off-budget items for funding investments and more on capex allocations. It also puts an end to the practice of funding Food Corporation of India's shortfall through borrowings from National Small Savings Fund (NSSF) and replaces it with budgetary allocation. As per CRISIL estimates, excluding the impact of inclusion of NSSF funds for FCI and Government fully serviced bonds, Fiscal deficit would have been lower about 0.5-1% of gross domestic product (GDP) in Fiscal 2021 and about 0.6% lower in Fiscal 2022

- **An eye on medium term**

It tries to lift the medium-term growth potential through a capex push and sharper focus on financial sector reforms such as:

  - **Recapitalising public sector banks (PSBs) so they can support economic recovery:** The pandemic landed a double whammy on a financial sector that was already weighed down by non-performing assets (NPAs) and slack credit demand. Frontloading of capital infusion for banks (Rs. 200 billion has been provided for Fiscal 2022) to withstand possible asset quality deterioration was an imperative.

- **Cleaning up bank books:** By creating asset management and reconstruction companies, the intention is to consolidate, manage and dispose of stressed assets of PSBs.

- **Disinvestment:** In another progressive step for the financial sector, the government, in the budget, also announced its intention to privatise two public sector banks (PSBs) and one general insurance company. The disinvestment process of Air India, BPCL, and Life Insurance Corporation of India (LIC) have been moved to fiscal 2022.

- **Bank Privatisation:** In another progressive step for the financial sector, the Government, in the budget, also announced its intention to privatise two public sector banks (PSBs) and one general insurance company.

- **Reforming the beleaguered manufacturing sector:** Manufacturing was in doldrums even before the pandemic struck, and was worst-affected in Fiscal 2021 after services. The budget announced more measures to address that in continuation with the Atmanirbhar Bharat package and production-linked incentive scheme, such as customs duty rationalisation, with particular focus on micro, small and medium enterprises (MSMEs).

- **Roadmap for public sector investment:** The budget bats for a massive push to infrastructure creation; it intends to augment funds for the flagship National Infrastructure Pipeline and lays down a roadmap to do so by increasing capex, monetising assets and developing instruments for infrastructure financing. That should, as earlier mentioned, have a high multiplier effect on growth and employment.

- **Asset monetisation:** The budget also announced the launch of the National Monetisation Pipeline (NMP) to leverage operating public infrastructure, the first of its kind in India. The Government envisages monetization of roads, railways, airports, and oil and gas pipelines under this initiative. The funding of the National Infrastructure Pipeline will critically hinge on the success of these efforts to monetise existing assets. NMP estimates aggregate monetisation potential of Rs 6 trillion through core assets of Central Government over a 4-year period from FY22-FY25.

Sector-wise monetisation pipeline over the next 4 years

Sector	Estimated Potential (Rs billion)
Roads	1,602
Railways	1,525
Power Transmission	452
Power Generation	398
Telecom	351
Warehousing	289
Mining	287
Natural Gas Pipeline	244
Product pipeline/ Others	225

Aviation	207
Urban Real Estate	150
Ports	129
Stadiums	115
Total	***6,000***

Source: NITI Aayog, CRISIL Research

- **Growth-led approach to heal pandemic-induced scars:** Post-pandemic recovery has been sharply uneven. Manufacturing is recovering faster led by policy support, pent up demand and some shift away from services. Services (especially contact-based ones like trade, hotels, transport and communication) continue to bear the brunt. Smaller firms and micro enterprises have been more severely hit than larger ones. And the rural poor received more support to incomes and jobs than the urban, who were also significantly affected. The budget attempts to correct some of these anomalies. The budget is premised upon infrastructure spending creating jobs for the unskilled and semi-skilled workforce.

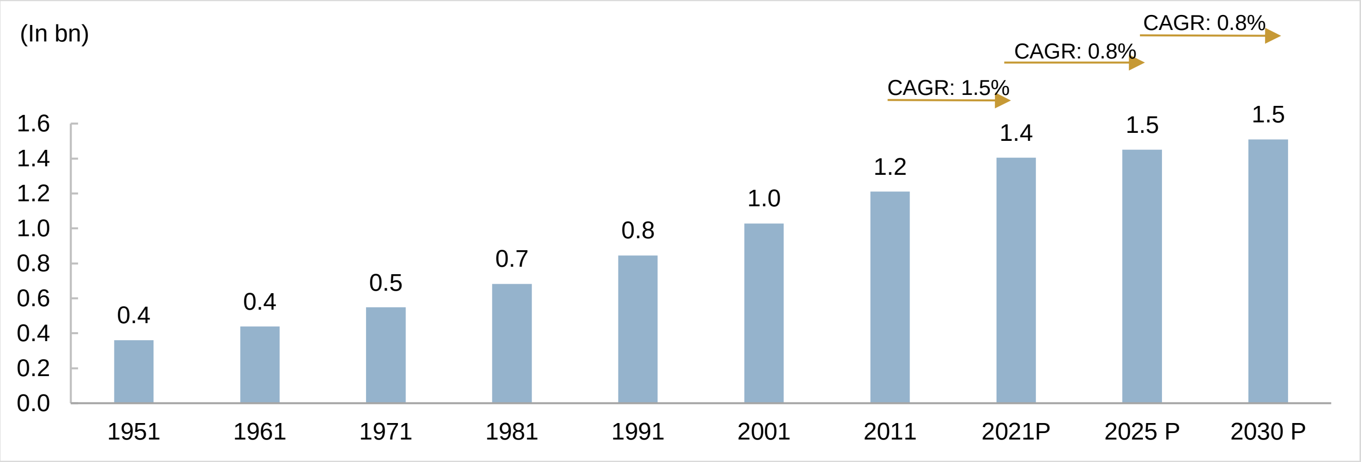
All in all, the economy is recovering faster than expected by CRISIL. Consistently good agriculture performance, successful flattening of the COVID-19 curve and a pick-up in Government spending in recent months has reduced the downside to the current Fiscal's de-growth and led to an upward revision in next Fiscal's growth prospects.

Key growth drivers

India has world's second largest population

As per Census 2011, India's population was ~1.2 billion, and comprised nearly 245 million households. The population, which grew nearly 18% between 2001 and 2011, is expected to increase about 11% between 2011 and 2021, to 1.4 billion. The population is expected to reach 1.5 billion by 2031 and number of households are expected to reach ~376 million over the same period.

India's population growth trajectory

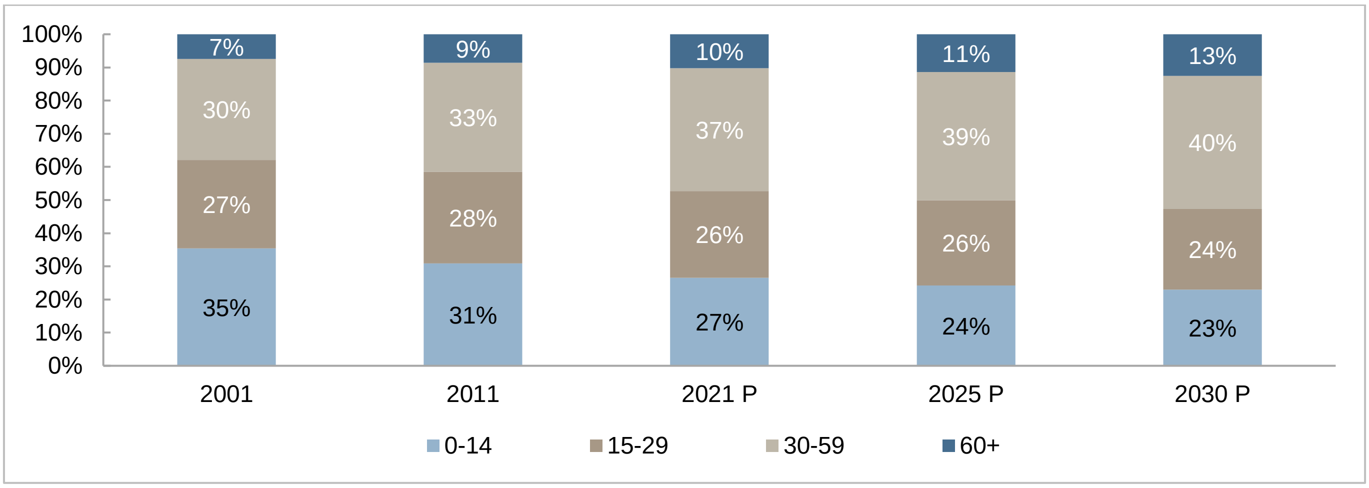


Note: P: Projected
Source: United Nations Department of Economic and Social affairs, CRISIL Research

Favourable demographics

As of 2020, India has one of the largest young populations in the world, with a median age of 28 years. About 90% of Indians will still be below the age of 60 by calendar 2021 CRISIL Research forecasts that 63% of them will be between 15 and 59 years. In comparison, in calendar year 2020, the United States (US), China and Brazil had 77%, 83% and 86%, respectively, of their population below the age of 60.

India's demographic dividend



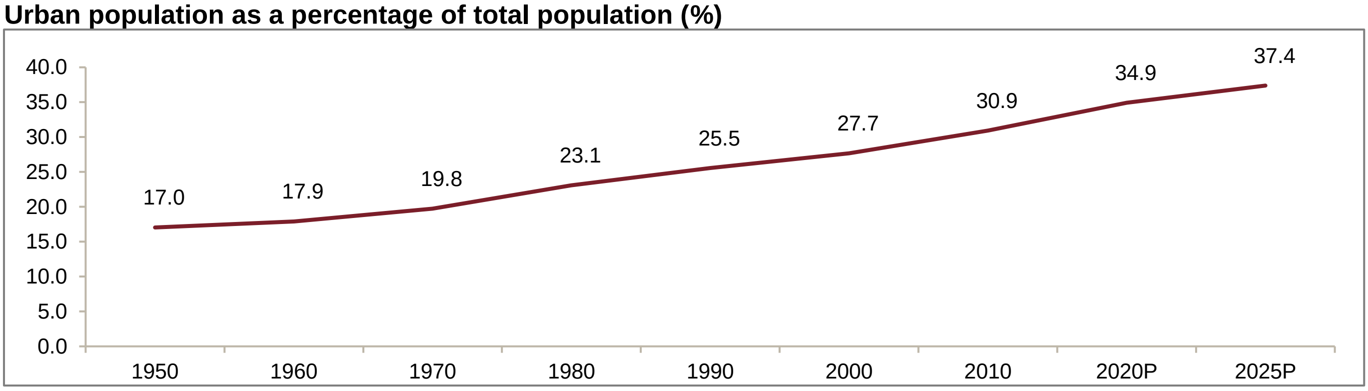
Note: E: Estimated

Source: United Nations Department of Economic and Social affairs, CRISIL Research

Urbanisation

Urbanisation is one of India's most important economic growth drivers as it will drive substantial investments in infrastructure development, which, in turn, is expected to lead to job creation, development of modern consumer services and increased ability to mobilise savings. The country's urban population has been rising consistently over the decades. In 1950, it was 17% of total population. As per the 2018 revision of World Urbanization prospects, it was estimated at 34% for India. This is expected to reach 37% by 2025.

Urban population as a percentage of total population (%)



Note: P - projected

Source: Census 2011, World Urbanization Prospects: The 2018 Revision (UN)

Increasing per capita GDP

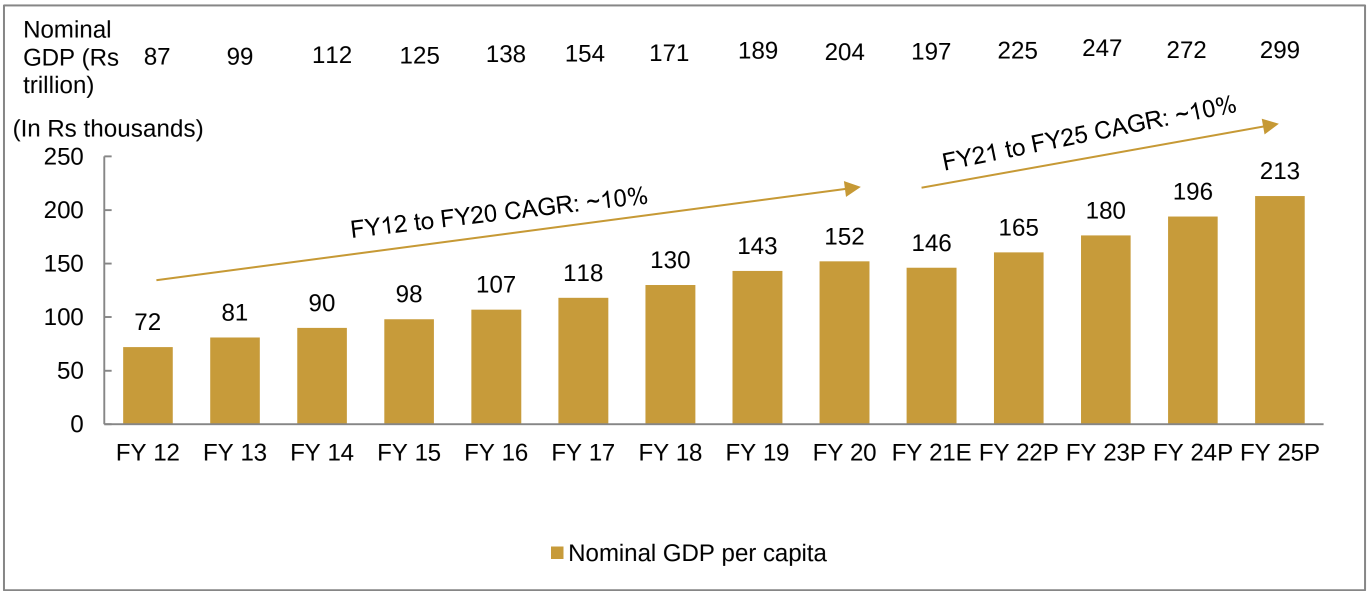
Per capita income is estimated to have contracted by 8% in Fiscal 2021 compared to a growth of 2.9% in the preceding Fiscal. CRISIL forecasts that the per capita income will gradually improve with a pick-up in GDP growth and sustained low inflation. This will be an enabler for domestic consumption. As per IMF estimates, India's per capita income (at constant prices) is expected to grow at 6.2% compound annual growth rate (CAGR) from Fiscals 2021-25.

Per capita income	Level in FY21 (INR thousands)		Growth at constant prices (%)									
	Current prices	Constant prices	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21 E	FY25P
	146	100	3.3	4.6	6.2	6.7	6.8	5.7	5.8	2.9	-8.0	6.2*

Note – E: Estimated, (*) - 4-year CAGR growth (FY21-FY25), As per IMF estimates of April 2021

Source – Ministry of Statistics and Program Implementation (MOSPI), International Monetary Fund (IMF), CRISIL Research

Trend in Nominal GDP per capita (at current prices)



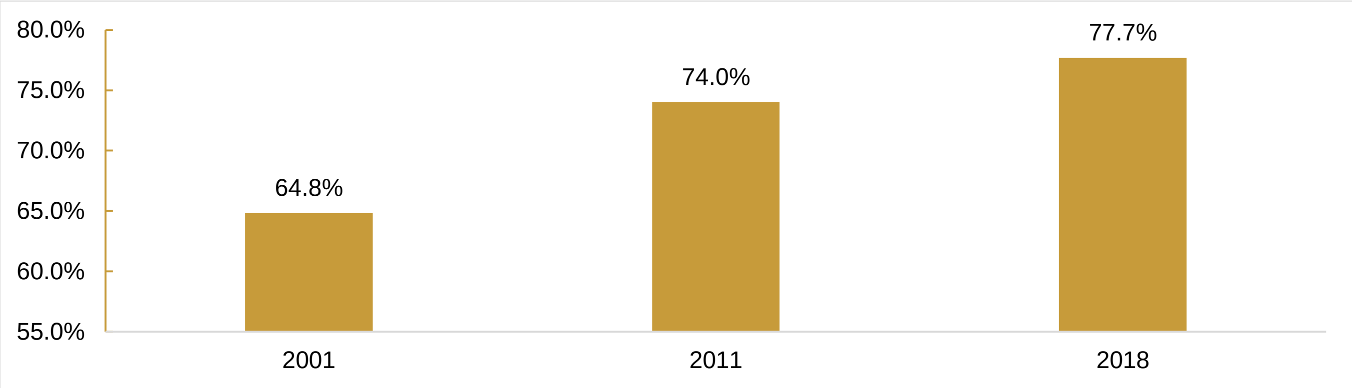
Note: P- Projected

Source: MOSPI, World Bank, CRISIL Research

Financial penetration to rise with increase in awareness of financial products

Overall literacy in India is at 77.7% as per the results of recent NSSO survey conducted in 2018 which is still below the world literacy rate of 86.5%. However, according to the National Financial Literacy and Inclusion Survey (NCFE-FLIS) 2019, only 27% of Indian population is financially literate indicating huge gap and potential for financial services industry. The survey defines financial literacy as combination of awareness, knowledge, skill, attitude and behaviour necessary to make sound financial decisions and ultimately achieve individual financial wellbeing.

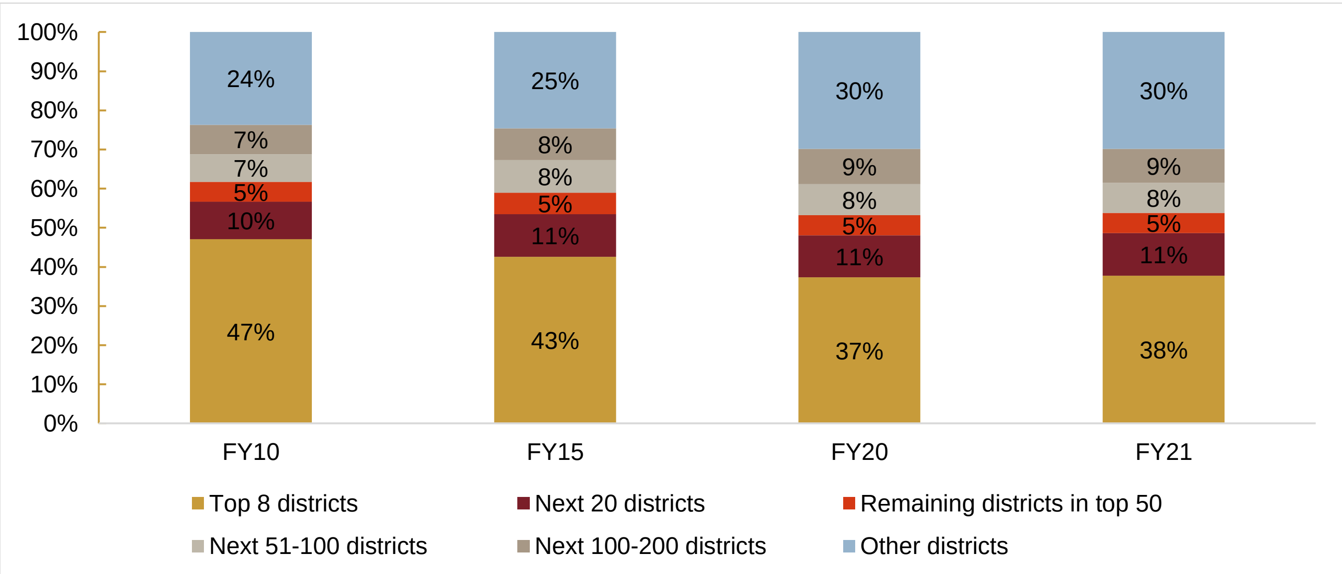
Overall literacy rate on a rise in India



Source: Census 2011, NSO Survey on household social consumption (2017-18),CRISIL Research

With increasing financial literacy, mobile penetration, awareness and the Prime Minister's Jan Dhan Yojana bank accounts (scheme aimed at bringing the unbanked under the formal banking system), there has been a rise in the participation of individuals from non-metro cities in banking. With more people attached to the formal banking sector, the demand for financial products in smaller cities has seen a major uptick in recent years. Going forward, CRISIL expects financial penetration to increase on account of increasing financial literacy.

Share of top 8 cities in banking deposits exhibits a reducing trend indicating increasing financial penetration



Note: 1) Classification of districts is done based on population as per Census 2011.

***2)** Mumbai Metropolitan Region (MMR), National Capital Region (NCR), Bengaluru and Kanpur have each been considered as a district.*
3) MMR includes Thane and Mumbai, NCR includes Delhi, Gurugram, Gautam Buddha Nagar, Ghaziabad and Faridabad, Bengaluru includes Bangalore Urban and Bangalore Rural, Kanpur includes Kanpur Nagar and Kanpur Dehat
Source: RBI, CRISIL Research

Digitisation aided by technology to play pivotal role in growth of economy

Technology is expected to play an important role by progressively reducing the cost of reaching out to smaller markets. India has seen a tremendous rise in fintech adoption in the past few years and has the highest fintech adoption rate globally of 87% which is significantly higher than the global average rate of 64% *(Source: InvestIndia)*. Among many initiatives by the government, the Unified Payments Interface (UPI) is playing a pivotal role towards financial inclusion. It provides a single-click digital interface across all system for smartphones linked to bank accounts and facilitates easy transactions using a simple authentication method. The volume of digital transactions has also seen a surge in the past few years, driven by increased adoption of UPI. Apart from financial services industry, digitisation in other industries like retail will also play an important role in growth of economy.

UPI usage data statistics

As of month end	No of banks live on UPI	Volume of transactions (million)	Amount of transactions (Rs. billion)	YoY growth (on value basis) in transactions (%)
March 2018	91	178	242	764%
March 2019	142	800	1,335	452%
March 2020	148	1,247	2,065	55%
January 2021	207	2,303	4,312	99%
February 2021	213	2,292	4,250	200%
March 2021	216	2,731	5,048	210%
April 2021	220	2,641	4,936	326%
May 2021	224	2,539	4,903	220%
June 2021	229	2,808	5,474	209%

Source: National Payments Corporation of India (NPCI)

Over the years, India has witnessed a strong push from government to improve the digital payments infrastructure in the country. Recently, on August 2, 2021, a digital payment instrument, namely e-RUPI, was launched. This instrument is developed over the existing UPI platform by National Payments Corporation of India (NPCI), in collaboration with Department of Financial Services, Ministry of Health and Family Welfare and the National Health Authority. e-RUPI is a cashless and contactless instrument for digital payment. It is a QR code or SMS string-based e-voucher, which is delivered to the mobile of the beneficiaries. The users of this seamless one-time payment mechanism will be able to redeem the voucher without a card, digital payments app or internet banking access, at the merchants accepting e-RUPI. e-RUPI would be shared with the beneficiaries for a specific purpose or activity by organizations or Government via SMS or QR code.

Measures to counter the pandemic's onslaught on growth

Reserve Bank of India goes all out to combat the crisis

The Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) slashed the repo rate by 115 basis points (bps) to address financial market stress in the wake of the pandemic and the subsequent lockdown. In an unusual move, the MPC also asymmetrically slashed the reverse repo initially by 90 bps and by another 25 bps and 40 bps subsequently. The repo and reverse repo rates now stand at 4.00% and 3.35%, respectively. To tide over any unwarranted volatility, the MPC also increased borrowing limits under the marginal standing facility (MSF) of the liquidity adjustment facility window from 2% to 3%. The MSF rate now stands at 4.25% (down from 5.40%).

The RBI also announced a host of other measures to address financial market stress due to the pandemic / lockdown:

- **Reducing debt servicing burden through moratorium period:** The RBI initially permitted lending institutions to allow a moratorium of three months on repayment of instalments for term loans outstanding as on March 1, 2020 and defer interest payments due on working capital facilities outstanding. The moratorium was further extended by another three months till August 31, 2020. However, the banks were instructed to provide 10% additional provisioning for availing this benefit, which could be later adjusted against the provisioning requirements for actual slippages. These measures are intended to boost confidence in the economy and provide relief to the borrowers

- **Loan restructuring:** The central bank constituted a committee which identified 26 sectors for restructuring which included aspects related to leverage, liquidity and debt serviceability to be factored by the lending institutions while finalising resolution plans for borrowers. However, only those borrower accounts would be eligible for resolution which were classified as standard, but not in default for more than 30 days with any lending institution as on March 1, 2020

- **Enhancing liquidity**: Apart from reducing repo and reverse repo rate, the RBI reduced the cash reserve ratio (CRR) requirements of all banks by 100 bps to 3% of net demand and time liabilities (NDTL). Further, the minimum daily CRR balance maintenance was reduced to 80% from 90% till June 26, 2020. In view of the exceptionally high volatility in domestic financial markets, the RBI also increased MSF borrowing limit from 2% to 3% of bank's NDTL up to June 30, 2020

- **Supporting financial market liquidity:** The RBI initially announced targeted long-term repo operations (TLTROs) of up to three years' tenure for a total of up to Rs 1 trillion. Liquidity availed under the scheme by banks had to be deployed in investment grade corporate bonds, commercial paper, and non-convertible debentures. Subsequently, TLTROs worth Rs 500 billion were announced specifically for non-banking financial companies (NBFCs) and micro finance institutions (MFIs), with 50% targeted towards small and mid-sized firms. Investments made by banks under this facility would be classified as held to maturity (HTM), and also be excluded under the large exposure framework. In addition, the government announced a Rs 450 billion partial credit guarantee scheme and Rs 300 billion special liquidity scheme, aimed at addressing the concern over credit risk perception on mid and small size non-banks.

- **Pushing credit growth:** The RBI decided to postpone the implementation of net stable funding ratio to October 1, 2021 to encourage banks to lend in these challenging times. Deferring the last tranche of capital conservation buffer to October 1, 2021 was also a step in the same direction. The central bank also announced Rs 500 billion refinancing facility for NABARD (Rs 250 billion), SIDBI (Rs 150 billion) and NHB (Rs 100 billion) to increase credit availability to microfinance, micro, small and medium enterprises (MSMEs) and the housing sector

- **Addressing rupee volatility:** Banks in India which operate International Financial Services Centre banking units have been allowed to participate in the Non-deliverable Forward (NDF) market with effect from June 1, 2020

- **Regulatory changes:** With regards to the moratorium provided on loans, the RBI clarified these measures would not result in asset quality downgrade, nor would it affect the credit history of borrower

- **Measures during second wave of Covid-19:** On May 5, 2021, RBI announced several measures to protect small and medium businesses, individual borrowers from the adverse impact of the intense second wave of Covid-19 across the country. RBI also made provisions for banks to advance loans to businesses and restructure loans for enhancing liquidity in the system to help mitigate the crisis. Restructuring framework 2.0 was announced wherein individuals, small businesses and MSMEs having aggregate exposure of up to Rs 250 million, who have not availed restructuring under any of the earlier restructuring frameworks (including under the Resolution Framework 1.0 dated August 6, 2020), and who were classified as 'Standard' as on March 31, 2021 are eligible to be considered. Restructuring under the proposed framework may be invoked up to September 30, 2021 and shall have to be implemented within 90 days after invocation. Further, for small businesses and MSMEs restructured earlier, banks and NBFCs have also been permitted, as a one-time measure, to review the working capital sanctioned limits, based on a reassessment of the working capital cycle, margins, etc. The RBI also permitted modification of plans under Restructuring framework 1.0 by increasing the period of moratorium and/or extending the residual tenor up to a total of 2 years.

Additionally, the RBI incentivised small finance banks (SFBs) to increase credit flow to small borrowers in two ways: one, by opening a special long-term repo operation (SLTRO) window of Rs. 100 billion for small finance banks (SFBs) for extending loans of up to Rs. 1 million to individuals and small businesses; and two, by classifying on-lending by SFBs to small MFIs with assets as less than Rs. 5 billion as priority sector lending. The facility will be available till October 31, 2021 and the RBI will hold an auction every month for this facility. In the may auction, the response from SFBs was muted where only Rs. 4 billion was auctioned out of the 100 billion facility. This was majorly because of ample liquidity with the small finance banks owing to lower credit demand in Fiscal 2021.

In June 2021, the RBI further enhanced the exposure limit for availing restructuring under restructuring framework 2.0 from Rs. 250 million to Rs. 500 million.

'Aatmanirbhar' package is a timely relief amid the pandemic

Liquidity boost for NBFCs

The government announced a Rs 450 billion partial guarantee scheme (for NBFCs) and Rs 300 billion special liquidity scheme for NBFCs, housing finance companies (HFCs) and MFIs, aimed at covering the concern of credit risk perception on mid and small size non-banks.

Change in MSME definition

To bring in more enterprises under the ambit of MSMEs and the relief package being offered by the regulator, the government revised the MSME investment limit across each category and introduced an alternate/additional criteria of turnover buckets to the definition. It further helped remove the difference between the definition of manufacturing based and services based MSMEs. Given below is the composite revised definition of MSMEs in comparison to the old existing one:

Existing and revised definitions of MSMEs

Existing MSME classification			
Criteria : Investment in plant and machinery or equipment			
Classification	Micro	Small	Medium
Manufacturing enterprises	Investment < RS 2.5 million	Investment < Rs 50 million	Investment < Rs 100 million
Services enterprises	Investment < Rs 1 million	Investment < Rs 20 million	Investment < Rs 50 million

Revised MSME classification			
Composite Criteria : Investment and annual turnover			
Classification	Micro	Small	Medium
Manufacturing and Services enterprises	Investment < Rs 10 million and Turnover < Rs 50 million	Investment < Rs 100 million and Turnover < Rs 500 million	Investment < Rs 500 million and Turnover < Rs 2.5 billion

Source: Ministry of MSME, CRISIL Research

Collateral-free loans to MSMEs (Rs 3 trillion)

Banks and NBFCs are directed to offer up to 20% of entire outstanding credit to MSMEs. MSMEs with up to Rs 250 million outstanding credits and Rs 1 billion turnover are eligible for these loans. It will have four-year tenure with a moratorium of 12 months on principal payment and can be availed till October 31, 2020. The government will provide complete credit guarantee cover to lenders on principal and interest amount.

Subordinate debt to MSMEs (Rs 200 billion)

The government is also facilitating the provision of Rs 200 billion as subordinate debt for stressed assets of MSMEs. It will also provide Rs 40 billion as partial credit guarantee support to banks for lending to MSMEs.

Equity infusion in MSMEs (Rs 500 billion)

The government has committed to infuse Rs 500 billion in equity of MSMEs having growth potential and viability. It will also encourage MSMEs to list on stock exchanges.

Clearing MSME dues; guarantee scheme

The government has requested central public sector enterprises to release all pending MSME payments within 45 days. It will boost transaction-based lending by fintech enterprises. Under the Emergency Credit Line Guarantee Scheme (ECLGS), banks will offer Rs 3 trillion government guaranteed loans to MSME borrowers that are not non-performing assets (NPAs) to address short-term liquidity concerns and boost the MSME sector.

Global tenders disallowed up to Rs 2 billion

The government will not allow foreign companies in government procurement tenders of value up to Rs 2 billion. This is likely to ease the competition faced by the MSMEs against foreign companies.

Loan interest subvention scheme (Rs 15 billon)

Under this scheme, the government has provided 2% interest subvention for loans given under Mudra-Shishu scheme. These loans are up to the ticket size of Rs 50,000 and are mostly given by NBFC-MFIs benefiting low income groups customers.

Special credit facility for street vendors (Rs 50 billon)

The government announced this scheme to facilitate easy access of credit to street vendors to offset the adverse effect of pandemic on their livelihoods.

‘Aatmanirbhar 3.0’ stimulus package rolled out to boost economy in November 2020

The finance minister, on November 12, 2020, announced a stimulus package. Under the package, 12 stimulus measures were rolled out to boost employment in the formal and informal economy, help housing infrastructure, enhancing ease of doing business, extending the deadline for the Credit Line Guarantee Scheme, etc. The announcement was made a day after the government announced a Rs 2 trillion production-linked incentives (PLIs) scheme for boosting identified manufacturing sectors. The government also announced some fresh projects, collaterally boosting employment in the country.

An additional outlay of Rs 180 billion for PM Awaas Yojana (PMAY) Urban was announced, which will help ground 1.2 million houses and complete 1.8 million houses. The move is expected to create additional 7.8 million jobs and improve production and sale of steel and cement, resulting in a multiplier effect on the economy. Stimulus packages worth Rs. 2.65 trillion were announced by the government.

Following are the twelve announcements made in the Aatmanirbhar 3.0 stimulus package:

1. Aatmanirbhar Bharat Rozgar Yojana: Aatmanirbhar Bharat Rozgar Yojana, operational during October 1, 2020 to June 2021 to incentivise creation of new employment opportunities during COVID recovery phase.

2. Emergency credit line guarantee scheme 2.0: Launch of an emergency credit line guarantee scheme 2.0 for guaranteed credit to 26 stressed sectors. Tenure of additional credit under ECLGS 2.0 to be 5 years, including 1 year of moratorium on principal repayment. Emergency credit line guarantee scheme extended till March 31 2021.

3. PLI scheme: Introduction of the PLI scheme in 13 key sectors for enhancing India's manufacturing capabilities and exports.

4. PMAY **–** Urban**:** Rs 180 billion will be provided over the Budged Estimates for 2020-21 for PM Awaas Yojana (PMAY) - Urban through additional allocation and extra-budgetary resources. This is over and above Rs 80 billion already budgeted this year.

5. Support for construction and infrastructure - Relaxation of earnest money deposit (EMD) and performance security on government tenders.

   - Performance security on contracts to be reduced to 3% instead of 5-10%
   - EMD will not be required for tenders and will be replaced by Bid Security Declaration
   - Relaxations will be given till December 31, 2021

6. Demand booster for residential real estate income-tax relief for developers and home buyers: Increase in the differential from 10% to 20% for the period from the date of the announcements to June 20, 2021 for only primary sale of residential units of value up to Rs 2 billion.

7. Government will invest Rs 60 billion as equity in the NIIF debt platform. Infra project financing of Rs 1.1 trillion will be provided by the government.

8. Government will provide support to farmers with Rs 650 billion for subsidised fertilisers

9. Boost for the rural employment -Enhanced outlays under PM Garib Kalyan Rozgar Yojana: Rs 400 billion was additionally provided in Atmanirbhar Bharat 1.0. Further outlay of Rs 100 billion to be provided for PM Garib Kalyan Rozgar Yojana in the current fiscal.

10. Boost for exports - Rs 30 billion to EXIM Bank for lines of credit: Rs 30 billion will be released to EXIM Bank for promotion of project exports through lines of credit under the IDEAS scheme.

11. Capital and industrial stimulus: Rs 102 billion additional budget outlay will be provided towards capital and industrial expenditure.
12. Research and development grant for Covid-19 vaccine development: Rs 9 billion provided for Covid Suraksha Mission for research and development of an Indian Covid-19 vaccine to the Department of Biotechnology

'Kamath Committee' identifies 26 sectors for loan restructuring

On August 7, 2020, the RBI announced the constitution of a committee under the chairmanship of KV Kamath to make recommendations on the required financial parameters for a 'Resolution framework for Covid-19 related stress. On September 4, the committee submitted the report which included aspects related to leverage, liquidity and debt serviceability for 26 sectors which could be factored by the lending institutions while finalising a resolution plan for a borrower. However, only those borrower accounts would be eligible for resolution which were classified as standard, but not in default for more than 30 days with any lending institution as on March 1, 2020. Under this framework, the resolution may be invoked not later than December 31, 2020 and must be implemented within 90 days from date of invocation for personal loans and 180 days for other exposures.

Scope of ECLGS Scheme further expanded post the COVID-19 wave

Recently in September 2021, with a view to support various businesses impacted by the second wave of COVID 19 pandemic, the timeline for Emergency Credit Line Guarantee Scheme (ECLGS) has been extended till March 2022 or till guarantees for an amount of Rs 4.5 lakh crore are issued under the scheme, whichever is earlier. Further, the last date of disbursement under the scheme has also been extended to June 2022. As of September 24, 2021, loans sanctioned have crossed Rs 2.86 trillion under the scheme.

In June 2021, the government increased the overall admissible guarantee limit from Rs 3.0 trillion to Rs 4.5 trillion. Along with this, the limit of admissible guarantee and loan amount is increased from 20% to 40% of outstanding for Covid-affected sectors like Hospitality sector, Travel & Tourism sector, Leisure & Sporting sector and Civil Aviation sector, subject to a maximum of Rs.200 crore per borrower.

Earlier, in May 2021, the Government announced the following further modifications to the ECLGS scheme:

- The scope was expanded to cover loans up to Rs. 20 million to hospitals/nursing homes/clinics/medical colleges for setting up on-site oxygen generation plants with interest rate capped at 7.5%
- Additional ECLGS assistance of up to 10% of the outstanding loans as on February 29, 2020 to borrowers covered under ECLGS 1.0 was allowed
- Civil Aviation sector was included in the list of sectors covered
- Ceiling of Rs. 5 billion of loan outstanding for eligibility under ECLGS 3.0 was removed, subject to maximum additional ECLGS assistance to each borrower being limited to 40% or Rs. 2 billion, whichever is lower
- Borrowers who had availed loans under ECLGS 1.0 of overall tenure of 4 years comprising of repayment of interest only during the first 12 months with repayment of principal and interest in 36 months were

allowed to increase the tenure to 5 years (repayment of interest only for the first 24 months with repayment of principal and interest in 36 months thereafter)

Earlier, in March 2021, the Government had made the following modifications to the scheme

- The scope of ECLGS was expanded to cover business enterprises in hospitality, travel & tourism, leisure & sporting sectors which had, as on February 29, 2020, total credit outstanding not exceeding Rs. 5 billion and were less than or equal to 60 days past due as on that date.
- The validity of ECLGS was extended up to June 30, 2021 or till guarantees for an amount of Rs. 3 trillion are issued.

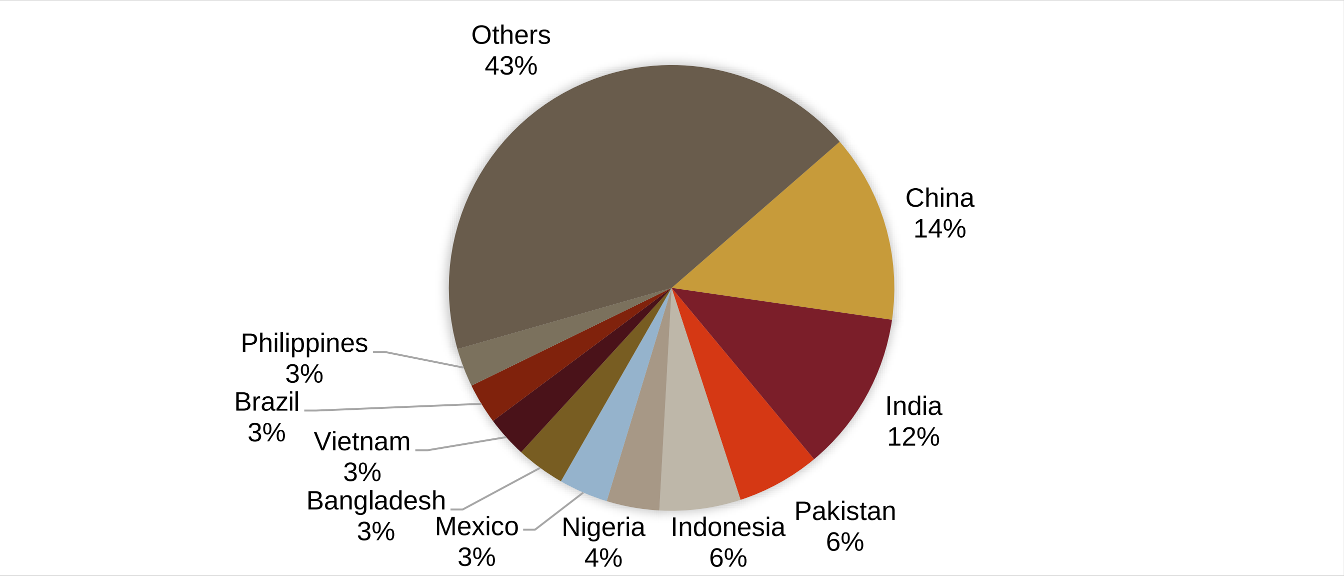
Key structural reforms: Long-term positives for the Indian economy

Financial inclusion

According to the World Bank's Global Findex Database 2017, the global average of adult population with an account (with a bank, financial institution, or mobile money providers) was ~69% in 2017. India's financial inclusion has improved significantly between 2014 and 2017, with the adult population with bank accounts rising from 53% (as per Global Findex Database 2014) to 80% in 2017 with concentrated efforts by the government to promote financial inclusion and the proliferation of supporting institutions. That said the rise in the number of bank accounts has not translated into a corresponding increase in the number of transactions and fruitful usage of those accounts. As per the World Bank's Global Findex Database 2017, 40% of the accounts did not make any deposit or withdrawal in the past year (2016), which indicates that although the account penetration has improved, usage of accounts is yet to improve.

As per the Global Findex Database 2017, ~50% of the world's unbanked adults are in India, Bangladesh, China, Indonesia, Mexico, Nigeria and Pakistan. Of the world's total unbanked adults (~1.7 billion), 415 million are from just two countries – India (11% or 190 million) and China (13% or 225 million), because of their huge population.

More than 50% of world's unbanked population in 10 countries indicating huge room for penetration



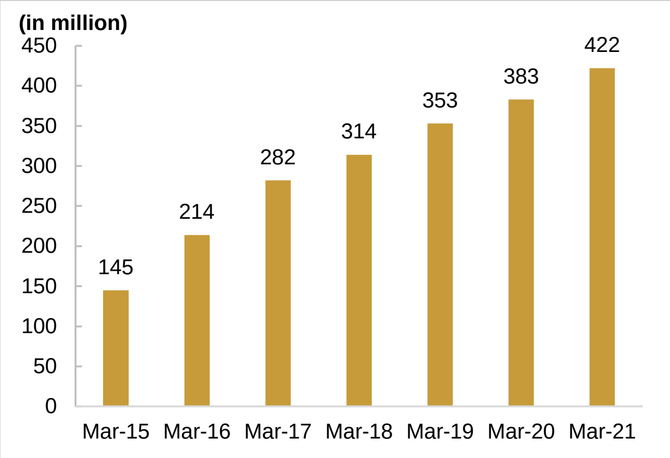
Source: World Bank - The Global Findex Database 2017, CRISIL Research

The two key initiatives launched by the government to promote financial inclusion are the Pradhan Mantri Jan Dhan Yojana (PMJDY) and Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY). Under the PMJDY, the government's aim is to ensure that every household in India has a bank account which they can access from anywhere and avail of all financial services such as savings and deposit accounts, remittances, credit and insurance affordably. PMJJBY is a one-year life insurance scheme that offers a life cover of Rs 0.2 million at a premium of Rs 330 per annum per member, which can be renewed every year. The government has also launched the Pradhan Mantri Suraksha Bima Yojana (PMSBY), which is an accident insurance policy and offers an accidental death and full disability cover of Rs 0.2 million at a premium of Rs 12 annually. As per the Government of India, more than 100 million people have registered for these two social security schemes.

Pradhan Mantri Jan Dhan Yojana (PMJDY), launched in August 2014, is aimed at ensuring ensure that every household in India has a bank account which they can access from anywhere and avail of all financial services such as savings and deposit accounts, remittances, credit and insurance affordably. PMJDY focuses on household coverage compared with the earlier schemes that focused on coverage of villages. It aims to extend banking facilities to all within a reasonable distance in each sub-service area (consisting of 1,000-1,500 households) across India.

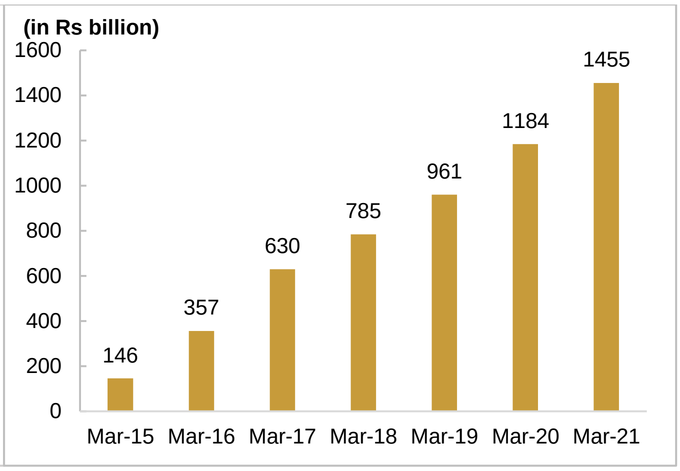
As on March 31, 2021, 422 million PMJDY accounts had been opened, of which, 66% were in rural and semi-urban areas, with total deposits of Rs 1,455 billion.

Number of PMJDY accounts



Source: PMJDY; CRISIL Research

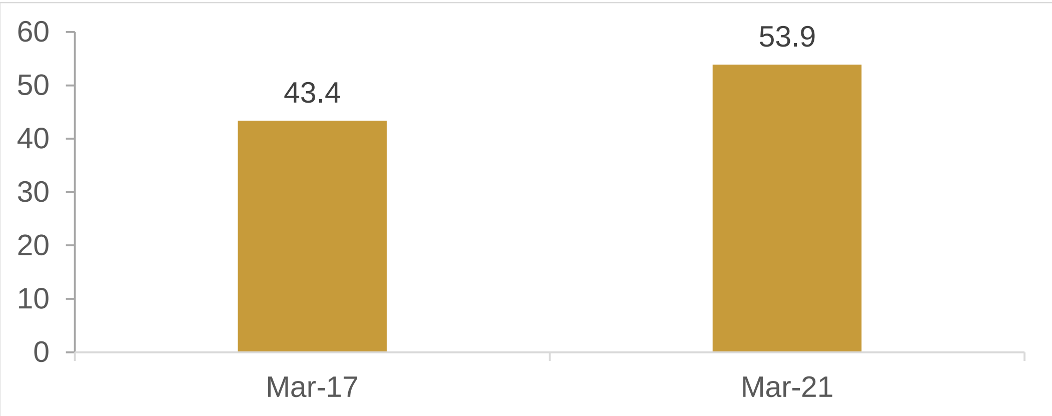
Total balance in PMJDY accounts



Source: PMJDY; CRISIL Research

In August 2021, RBI introduced an annual index to measure and improve the extent of financial inclusion in the country. The index covers details of banking, investments, insurance, postal and pension sector while arriving at the score. The index comprises of three broad parameters viz., Access (35% weightage), Usage (45% weightage), and Quality (20% weightage) with each of these consisting of various dimensions, which are computed based on a number of indicators. In total, the index has 97 indicators which are responsive to ease of access, availability and usage of services and quality of services. The index also captures the quality aspect indicated by factors such as financial literacy, consumer protection, and inequalities and deficiencies in services. The index, which has been constructed without any base year, captures broad aspects of financial inclusion in a single value ranging between 0 and 100, where 0 represents complete financial exclusion and 100 indicates full financial inclusion.

India's Financial Index Score



Source: RBI

(Financial inclusion is covered in greater detail in next chapter)

GST implementation

Introduced on July 1, 2017, the GST is an indirect tax regime that subsumed multiple cascading taxes levied by the central and state governments. Its implementation has spawned structural changes in the supply chain and logistics network in the country. The crux of the GST mechanism is input tax credit, which ensures more players in the supply chain come under the tax ambit. As supply from only registered taxpayers will get input tax credit, businesses and stakeholders will insist on registration of their suppliers and traders, leading to an increase in the share of organised participants. The GST regime has been stabilising fast and is expected to bring more transparency and increase in formalisation, eventually leading to higher economic growth.

PLI scheme to boost manufacturing in the long run

The government has budgeted ~Rs 2 trillion to give incentives to the locally manufacturing units to 13 key sectors. The key sectors expected to get benefit from the scheme include automobiles, pharma, telecom, electronics, food, textile, steel and energy. By incentivising production subject to achieving the desired scale, the scheme aims to spawn a handful of globally competitive large scale manufacturing units in the identified sectors. Furthermore, the government also hopes to reduce India's dependence on raw material imports from China. The scheme is expected to provide a boost to economic growth over the medium-term and create more employment opportunities as many of these sectors are labour intensive in nature.

Broad Sector	Segment	Budgeted (Rs. Bn)*	
Automobiles	Advance Chemistry Cell (ACC) Battery	181	441
	Automobiles & auto components	260	
Electronics	Mobile manufacturing and specified electronic Components	409	521
	Electronic/technology products	50	
	White goods (ACs & LED)	62	
Pharma and medical equipment	Critical key starting materials/drug intermediaries and active pharmaceutical ingredients	69	253
	Manufacturing of medical devices.	34	
	Pharmaceuticals drugs	150	
Telecom	Telecom & networking products	122	122
Food	Food products	109	109
Textile	Textile products: MMF segment and technical textiles	107	107
Steel	Speciality steel	63	63
Energy	High efficiency solar PV modules	45	45
Total			**1662**

**Approved financial outlay over a five-year period*

Source: Government websites; CRISIL Research

Thrust on affordable housing

The residential real estate segment saw two policy changes – Real Estate (Regulation and Development) Act (RERA) and Goods and Services Tax (GST) -- which had a direct impact on the sector's demand-supply dynamics. Consequently, new launches dropped sharply, with developers focussing on completing ongoing projects. The sector had been battling weak demand for the past couple of years, and one of the key reasons was unaffordability, as developers focussed on the middle and premium income-category projects. However, government initiatives have prompted developers to explore affordable housing as a new area. Going ahead, about half of the incremental supply being added in urban stock is expected to be via affordable housing. Additionally, the formalisation of the industry is likely to bring in more transparency, leading to an increase in consumer demand.

In a major relief to real estate sector, the government has extended the timelines of RERA projects by six months for projects expiring on or after March 25, 2020. Further, in affordable housing, it has extended the deadline to March 31, 2022 for first time homebuyers to avail additional Rs 150,000 interest deduction on home loans.

PMAY U and G have been focused to provide affordable housing for lower income group and Economic weaker section households which is nothing but affordable housing in country. The government remains focused on the PMAY U and G, and as of July, 2021, construction of close to 18.5 million homes across urban and rural regions have been completed.

PMAY Gramin (Rural)

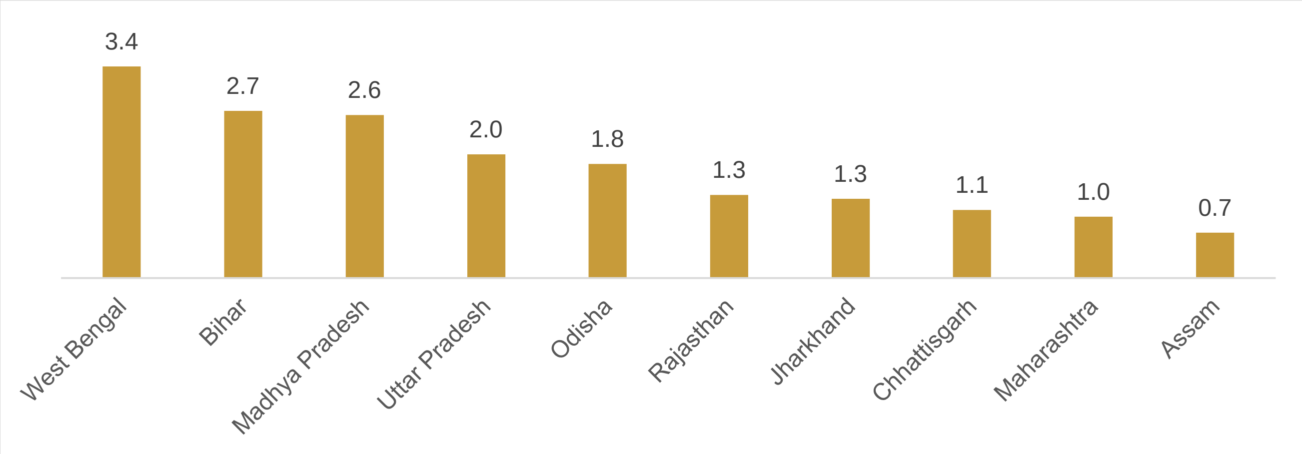
Under the PMAY-Gramin (PMAY-G), as many as 15.5 million houses were completed as of September 2, 2021. The government has set up a target of constructing 20.19 million houses by fiscal 2022 under the scheme. CRISIL Research believes budgetary allocation for the scheme is insufficient. As a result, it will have to rely heavily on extra budgetary resources raised through NABARD bonds. The flow of funds will be key factor with high investment requirement as against funds transferred of ~Rs. 1.8 trillion. Till September 2 2021, around 19.6 million houses were sanctioned under PMAY Gramin.

PMAY G status (as of September 2, 2021)

	Target	Sanctioned	Completed	Funds Transferred (Rs. Billion)
PMAY G	20,196,433	19,601,289	15,546,511	1,841

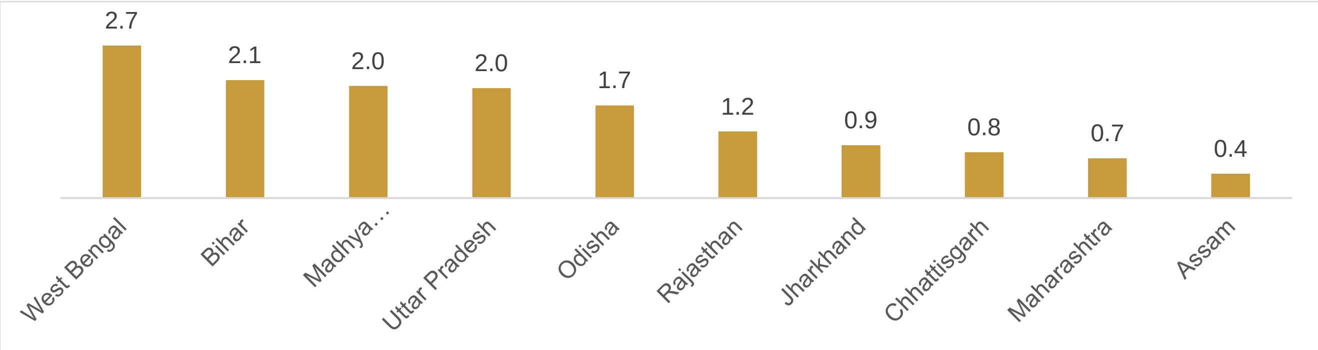
Source: PMAY-G, CRISIL Research

PMAY G – Houses Sanctioned (as on 2nd September, 2021) - million



Source: PMAYG, CRISIL Research

PMAY G – House completed (as on 2nd September, 2021) – million



Source: PMAYG, CRISIL Research

PMAY Urban

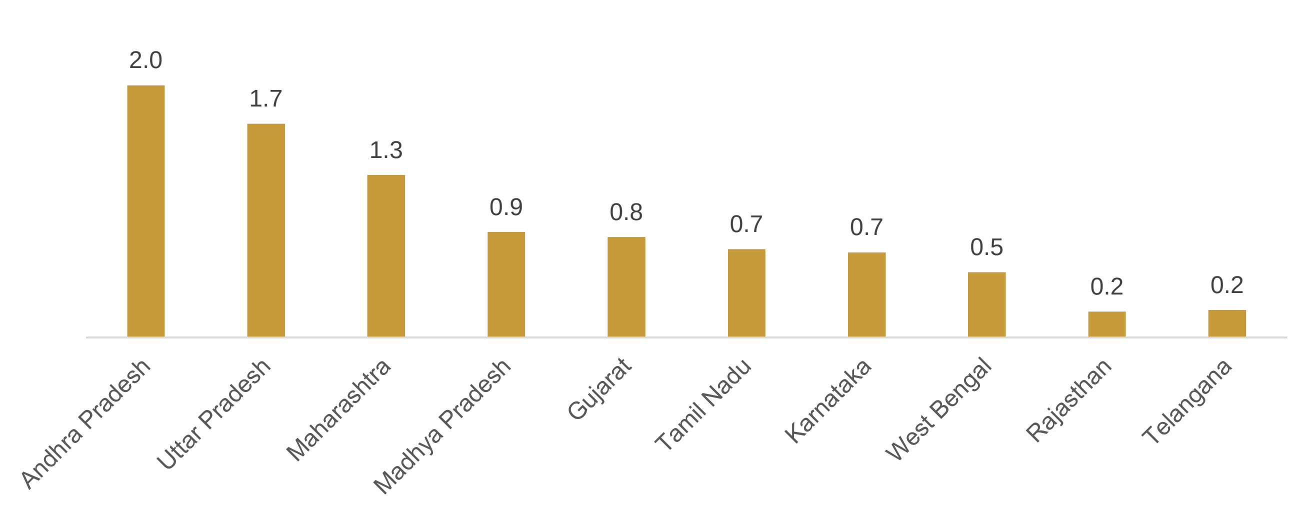
Under the PMAY-U, of the estimated 11 million houses to be constructed over seven years (fiscals 2016-2022), 11.31 million have been sanctioned as of August 31, 2021 and 5.02 million have been constructed. As on August 31, 2021, the Government has sanctioned ₹ 1.8 trillion towards this scheme. However, the central assistance released is about ₹ 1.08 trillion, which amounts to approximately 60% of the required assistance. Like the PMAY-G, the PMAY-U also relies heavily on extra budgetary resources raised through Housing and Urban Development Corporation Ltd bonds. The flow of funds from the central government is crucial for the scheme's success.

PMAY U status (as of August 31, 2021)

	Target	Sanctioned (million)	Houses Grounded (million)	Completed (million)	Funds Released (Rs. Billion)
PMAY U	Housing for All	11.31	8.62	5.02	955.87

Source: MOHUA, CRISIL Research

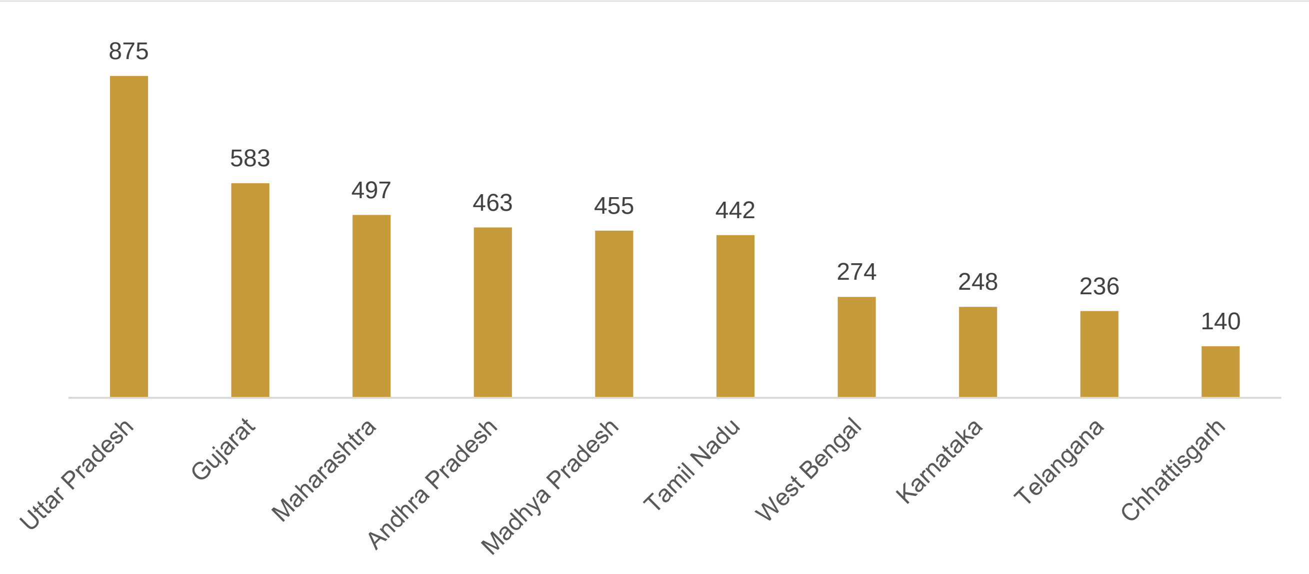
PMAY U – House sanctioned (As on 31st August, 2021) - million



Source: MOHUA, CRISIL Research

Till August 2021, Andhra Pradesh state has received the highest number of house sanctioned followed by Uttar Pradesh and Maharashtra. These three states are followed by Madhya Pradesh, Gujarat, Tamil Nadu and Karnataka.

PMAY U – Houses completed (As on 31st August, 2021 – unit in 000's)



Source: MOHUA, CRISIL Research

IBC a key long-term structural positive

The Insolvency and Bankruptcy Code (IBC) is a reform that will structurally strengthen the identification and resolution of insolvency in India. Until November 2019, financial service providers were not covered under the IBC framework. In November 2019, the government notified the rules on applicability of IBC will cover NBFCs (including housing finance companies) with an asset size of Rs 5 billion or more. The IBC enhances the credit enforcement structure and provides certainty around the timeframes for insolvency resolution. It attempts to simplify legal processes, preserve value for creditors and provide them with greater certainty of outcome. With this reform, the RBI has sent a strong signal to borrowers to adhere to credit discipline and also encourage banks to break resolution deadlocks by introducing definite timelines. IBC will enhance investors' confidence when investing in India. Internationally, recovery rates have improved significantly after the implementation of bankruptcy reforms, as can be seen in the following table:

Country	Year of bankruptcy reform	Pre-reforms		Five years post-reforms	
		Recovery rate (%)	*Time (years)*	*Recovery rate (%)*	*Time (years)*
Brazil	2005	0.2	10.0	17.0	4.0
Russia	2009	28.2	3.8	42.8	2.0
China	2007	31.5	2.4	36.1	1.7
India	2016	26.0	4.3	43*	1.6*

*Note: * As of 2019*

Source: World Bank, CRISIL Research

Reduction in corporate tax rates to boost capital base of financial institutions

On September 20, 2019, the Finance Minister announced Taxation Laws (Amendment) Ordinance 2019 to make certain amendments in the Income Tax Act, 1961, to allow any domestic company an option to pay income tax at the rate of 22%, subject to the condition that they will not avail of any exemption/incentive. The effective tax rate for these companies will be 25.17% inclusive of surcharge and cess. Also, such companies will not be required to pay minimum alternate tax.

A company that does not opt for the concessional tax regime and avails of the tax exemption/incentive will continue to pay tax at the pre-amended rate. However, these companies can opt for concessional tax regime after expiry of their tax holiday/exemption period. After the exercise of the option they will be liable to pay tax at the rate of 22% and the option, once exercised, cannot be subsequently withdrawn. Further, in order to provide relief to companies which continue to avail of exemptions, the rate of minimum alternate tax has been reduced from 18.5% to 15%.

In addition, to stabilise the flow of funds in the capital market, the provision of not applying additional surcharge as per the Finance Act, 2019, on capital gains arising out of sale of equity share in a company or unit of equity oriented fund or business trust liable for securities transaction tax, in the hands of an individual, Hindu undivided family (HUF), association of persons (AOP), body of individuals (BOI) and artificial judicial person (AJP). The enhanced surcharge will also not apply to capital gains on sale of any security, including derivatives, in the hands of foreign portfolio investors. Also, to provide relief to listed companies that have announced share buyback before July 5, 2019, tax on the buyback of shares will not be charged as per these latest amendments.

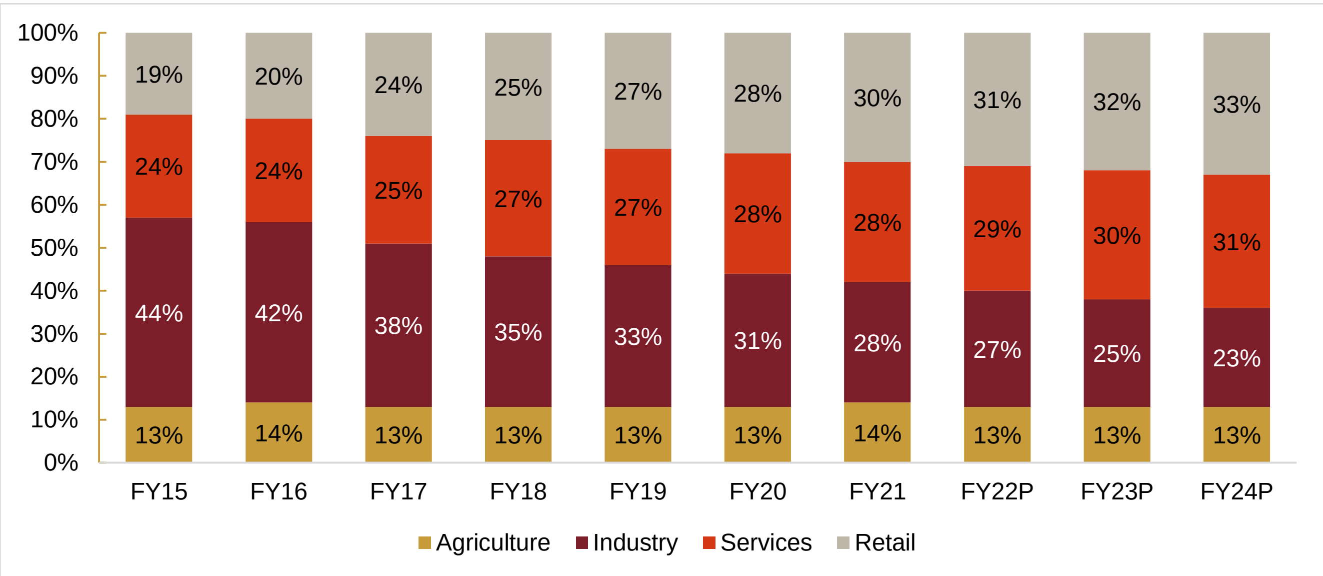
The recent amendments could boost the capital base of the financial institutions and help revive growth in the financial services sector, which has been battling with high NPAs, increasing defaults and liquidity concerns. This move could also revive the private capex cycle leading to credit growth in the economy.

Credit penetration in India

Retail sector to bounce back from fiscal 2022

Industrial credit accounted for nearly a third of the overall banking credit mix in Fiscal 2019. The demand has been lower in the past three fiscal years, owing to subdued capital expenditure and low commodity prices. The sector has been plagued with worsening asset quality, which has reached 17.5% in fiscal 2019 as compared to 7.2% in fiscal 2015. This has led to gradual reduction of share of industry credit in the overall banking sector's credit. CRISIL Research expects the growth to stay low towards this sector on account of cautious approach taken by lenders. In contrast, credit towards the retail and services segments has risen rapidly over the past five fiscal years, driven by strong consumer demand, lower NPA and better margins. Because of this, their shares in the overall banking credit mix have been expanding. However, in fiscal 2021, retail credit clocked slower growth as private consumption plunged on account of Covid-19 pandemic and its profound impact on economic activity. However, between fiscal 2021 and fiscal 2024, retail credit is expected to make a strong comeback and grow at 13-15%.

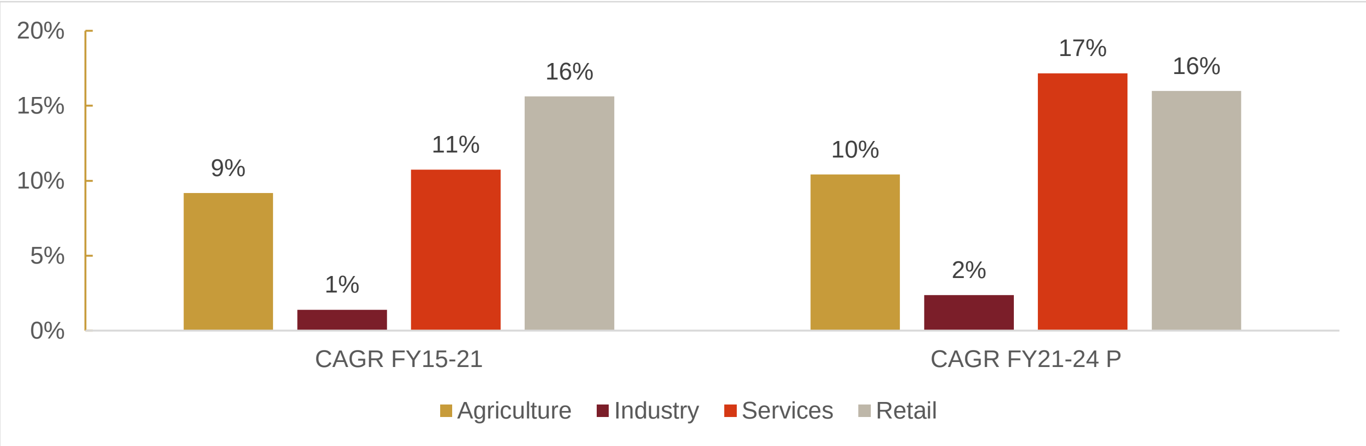
Retail loan has the largest share in banking credit; will continue to form largest share at 33% in FY24



Note: P: Projected

Source: RBI; CRISIL Research

Trend in growth of bank credit of various segments



Note: P: Projected

Source: RBI; CRISIL Research

Increasing retail penetration to support credit growth

Household debt-to-GDP ratio measures the credit penetration of the household sector in an economy. India ranks one of the lowest in this parameter. However, this ratio has been rising with increase in formalisation, rise in income levels, and improving banking penetration in the country. This is further supported by strong retail focus by banks, as this segment offers better risk-to-reward. We expect this pace to continue in medium term, given huge under-penetration in the segment, and supported by rapid growth in income levels.

Total credit-to-GDP ratio to pick up in the long-term on the back of structural reforms

Total credit-to-GDP ratio (total credit to for private non-financial sector), which measures the financial sector penetration in the economy, has been observed to be one of the lowest in case of India (~56% as of 2019) compared with other developing BRICS economies, such as China (~204%) and South Africa (~73%), and developed economies, such as the United States (~150%), United Kingdom (~163%) and France (~215%). Faster economic growth, improving digitisation initiatives, increasing banking penetration, and government's implementation of structural reforms such as IBC, augur well for the total credit to GDP ratio in the long term.

Greater credit penetration will increase proportion of new-to-credit customers

In India, the proportion of new-to-credit customers has been showing a steady increase across segments, indicating increasing comfort of the younger population in availing credit and a consequent increase in credit penetration. According to CRIF Highmark data, the proportion of new-to-credit (NTC) customers in fiscal 2021 was around 35% in the case of consumer durable loans, 34% in the case of business loans 18% in the case of credit cards, 19% for personal loans, and 28% for auto loans. In the case of two wheelers, as much as 65% of the loans in fiscal 2021 were given to NTC borrowers.

	Proportion of new-to-credit customers
Home loans	10-15%
Personal loans	19%

Credit cards	18%
Auto loans	28%
Business Loans	34%
Consumer durable loans	35%

NTC defined as loans with borrower vintage <= 12 months
Source: Industry, CRIF Highmark, CRISIL Research estimates

Household savings to increase

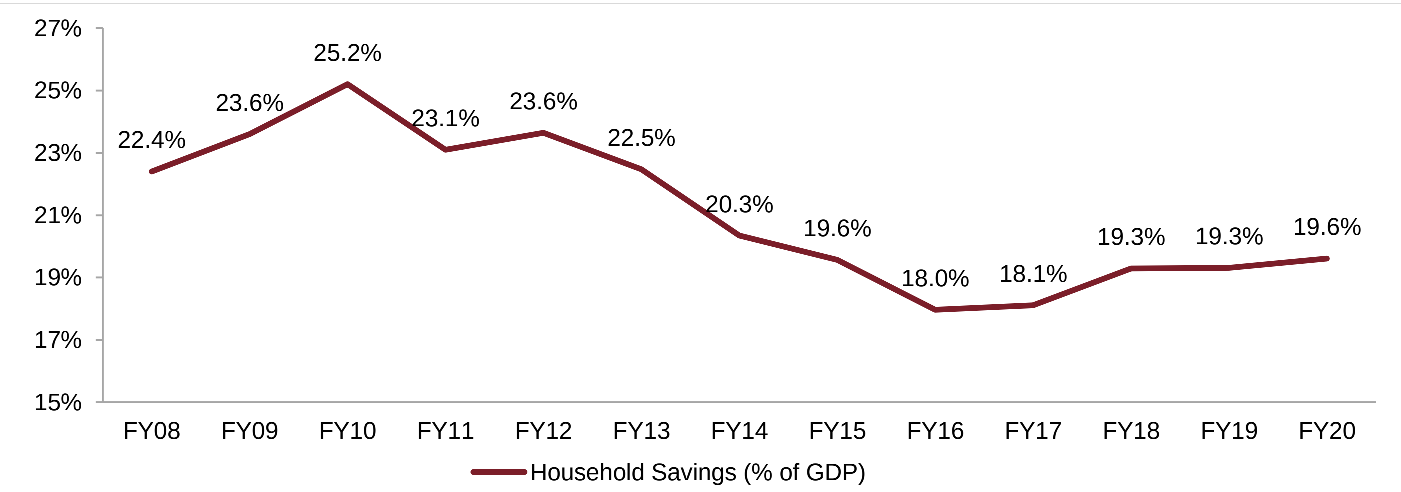
India's slowing economy took a toll on much-needed savings too, with the savings rate touching a 15-year low, and household savings also falling. This has weakened India's macro-economic position which is already hobbled by low investment and rising external borrowing to fund capital needs. Household savings also declined as consumers spent more in purchasing durables and travelling. Indian households contribute to about 60% of the country's savings. But India remains favourable compared with emerging market peers such as Brazil.

According to World Bank, the savings rate, or the proportion of gross domestic savings (GDS) in GDP in the Indian economy has trended down in the past decade. India's GDS peaked at 36.8% of GDP in Fiscal 2008 and dipped to 32.0% in Fiscal 2009. That was largely on account of a sharp slowdown in public savings, as the Government resorted to Fiscal stimulus to address the external shock from global financial crisis (GFC).

CRISIL Research expects India to continue being a high savings economy. However, household savings as a percentage of GDP has been sliding since Fiscal 2012, with its share in total savings falling significantly from 23.6% in Fiscal 2012 to 18.0% in Fiscal 2016. The household savings as percentage of GDP rose to 19.6% in Fiscal 2020. CRISIL Research expects the household savings as a percentage of GDP to increase further on account of expected decline in discretionary spending during the pandemic. However, the absolute amount of savings might not increase at the same pace since the GDP growth is expected to be negative in Fiscal 2021.

CRISIL is also sanguine on savings rate increasing in the medium-term, as households become more focused post the pandemic-induced uncertainty on creating a nest egg for the future.

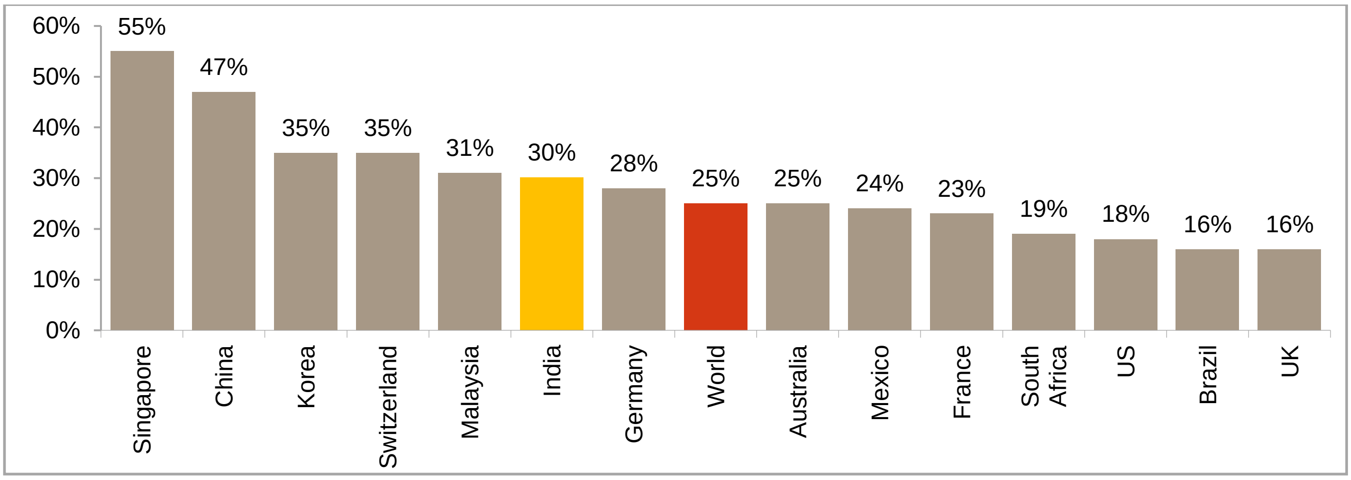
Household savings as a percentage of GDP has increased marginally in Fiscal 2020



Note: E: Estimated

Source: Ministry of Statistics and Programme Implementation (MOSPI), RBI, CRISIL Research

Gross Domestic Savings rate: India vs other countries (CY 2019)



*Note: Gross Domestic Saving consists of **savings of household sector, private corporate sector and public sector***

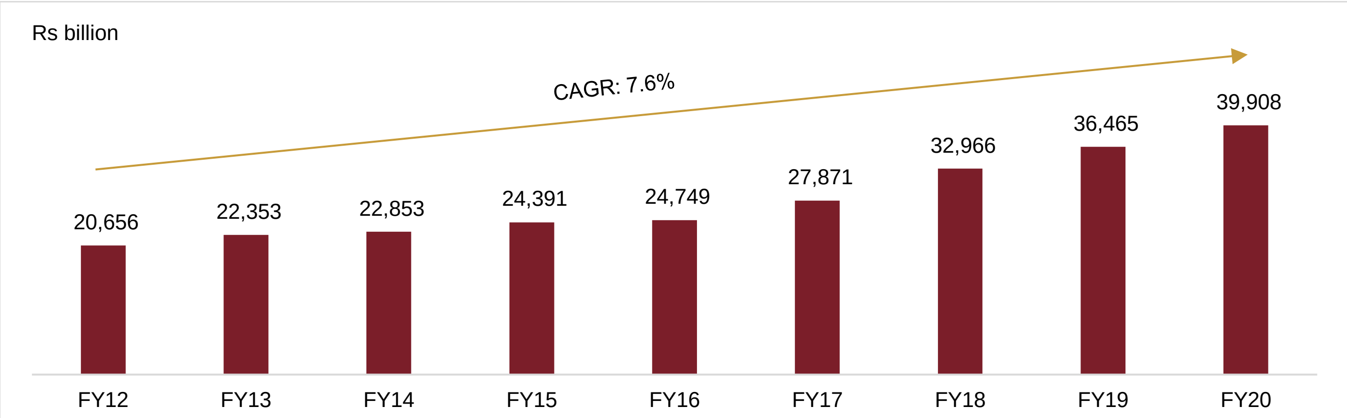
Source: World Bank, Handbook of Statistics on Indian Economy 2018-19, RBI, MOSPI, CRISIL Research

Gross domestic savings trend

Parameters (Rs.billion)	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20
GDS	33,692	36,082	40,200	42,823	48,251	54,807	57,770	63,860
GDP (At current prices)	99,440	112,335	124,680	137,719	153,917	170,900	188,870	203,510
Percentage of GDP	33.9%	32.1%	32.2%	31.1%	31.3%	32.1%	30.6%	31.4%
Household sector savings (net financial savings, savings in physical assets and in the form of gold and silver ornaments)	22,353	22,853	24,391	24,749	27,871	32,966	36,465	39,908
Percentage of GDP	22.5%	20.3%	19.6%	18.0%	18.1%	19.3%	19.3%	19.6%
Gross financial savings	10,640	11,908	12,572	14,962	16,147	20,564	21,341	22,846
Financial liabilities	3,304	3,587	3,768	3,854	4,686	7,507	7,784	6,641
Savings in physical assets	14,650	14,164	15,131	13,176	15,946	19,442	22,481	23,272
Savings in the form of gold and silver ornaments	367	368	456	465	465	467	427	431

Note: The data is for financial year ending March 31; Physical assets are those held in physical form, such as real estate, etc.
Source: MOSPI, National Accounts National Accounts Statistics, CRISIL Research

Household savings growth



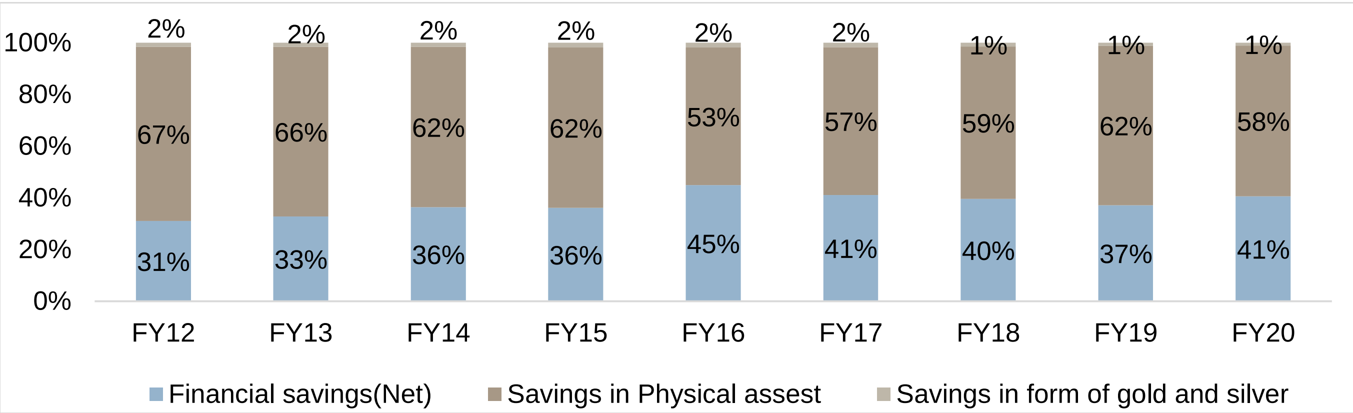
Note: The data is for financial year ending March 31

Source: MOSPI, CRISIL Research

Share of physical savings to remain stable in the wake of COVID

While households' savings in physical assets has declined to 58% in Fiscal 2020 from 67% in Fiscal 2012, financial savings has witnessed an uptrend to 41% in Fiscal 2020 from 31% in Fiscal 2012.

With volatility in the financial markets post COVID and the prevalent lower rates of return in the fixed income products on account of accommodative stance of the central bank, some proportion of savings is expected to continue to remain in the physical assets. In the long-term, with increase in financial literacy, CRISIL expects the share of financial assets as a proportion of net household savings to increase over the next five years, thereby boosting investments in assets such as insurance and mutual funds.



Note: The data is for financial year ending March 31
Source: Handbook of Statistics on Indian Economy 2018-19, RBI, MOSPI, CRISIL Research

Rural economy is becoming structurally far more resilient

At a time when the Indian economy has been severely impacted by the COVID-19 pandemic, the rural economy, which accounts for almost half of India's GDP, has been a harbinger of hope. Rural India emerged relatively unscathed from the first Covid-19 wave due to lower spread of the pandemic in these areas, agricultural activity continuing unhindered, additional support offered by the government by increasing allocation under the Mahatma Gandhi National Rural Employment Guarantee Act (MNREGA) and disbursing funds under the PM-Kisan scheme, and the relatively lower contribution of services, most badly hurt due to the pandemic, in the rural GDP. Further, higher Government procurement of food grains to support the Pradhan Mantri Garib Kalyan Anna Yojana, also spurred higher production.

The second wave of Covid-19 has had some impact in rural India, thereby hurting household balance sheets. This, along with the progress of the monsoons and sowing activity in respect of kharif crops, would influence rural incomes in the near-term.

Nevertheless, CRISIL Research believes that the rural economy is far more resilient today due to two consecutive years of good monsoon, increased spends under MNREGA and irrigation programmes, direct benefit transfer (DBT), the PM-Kisan scheme, PM Ujwala Yojana for cooking gas, PM Awas Yojana for housing, and Ayushman Bharat scheme for healthcare. To supplement this, there has been a continuous improvement in rural infrastructure such as electricity and roads. These Government initiatives have led to lesser leakages and higher incomes in the hands of the rural populace, thereby enhancing their ability and willingness to spend on discretionary products and services.

Through Direct Benefit Transfer, the government has transferred more than Rs 5.5 trillion in fiscal 2021 under 318 schemes. In the coming years as well, CRISIL Research expects DBT transfers to continue to increase at a healthy pace, as the government tightens focus on making subsidies available directly in the account of the intended beneficiaries.

The structural changes, combined with a positive macro environment, will improve rural business prospects, provide business opportunities for the banking and financial services sector and drive the long term growth of the economy.

Access to bare necessities across rural areas has improved considerably over the last few years

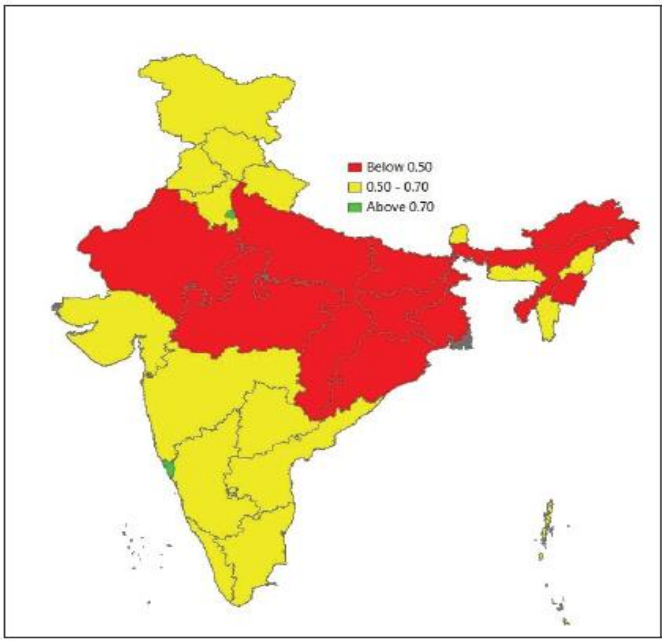
The bare necessities index (BNI), which was included as part of the Economic Survey for 2020-21, indicates how the access to bare necessities in semi-urban and rural areas has improved considerably in the last few years, thereby enhancing the quality of life and aspirations of the populace.

The BNI summarises 26 indicators on five dimensions viz., water, sanitation, housing, micro-environment, and other facilities. The BNI has been created for all states for 2012 and 2018 using data from two NSO rounds (69th and 76th) on drinking water, sanitation, hygiene and housing conditions in India. The BNI indicates that access to the bare necessities has improved across all States in the country in 2018 as compared to 2012. Access to bare necessities is the highest states such as Kerala, Punjab, Haryana and Gujarat while it is the lowest in Odisha, Jharkhand, West Bengal and Tripura. The improvements are widespread as they span each of the five dimensions. Furthermore, inter-state disparities in the access to bare necessities have declined in 2018 when compared to 2012 across rural and urban areas. This is because the states where the level of access to the bare necessities was low in 2012 have gained relatively more between 2012 and 2018. Access to the bare necessities has improved disproportionately more for the poorest households when compared to the richest households across rural and urban areas.

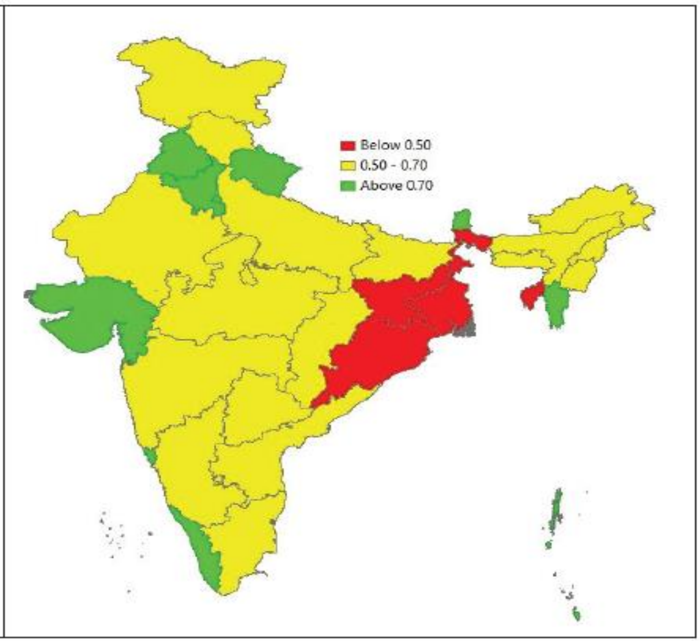
The below graphs indicate the state-wise values of BNI in 2012 and 2018 for India as a whole as well as urban and rural areas. A higher value indicates better access to bare necessities in a state ad vice-versa. The three colours, green, yellow and red, used in the maps show the level of a state in providing access to bare necessities to its households. Green (above 0.70) indicates high level, followed by yellow (0.50 to 0.70), which indicates medium level.

In contrast, red (below 0.50) indicates very low level of access. The difference in colours in a map indicate the regional variation in the access to bare necessities for the households.

Pan-India BNI (Urban + Rural in 2012)

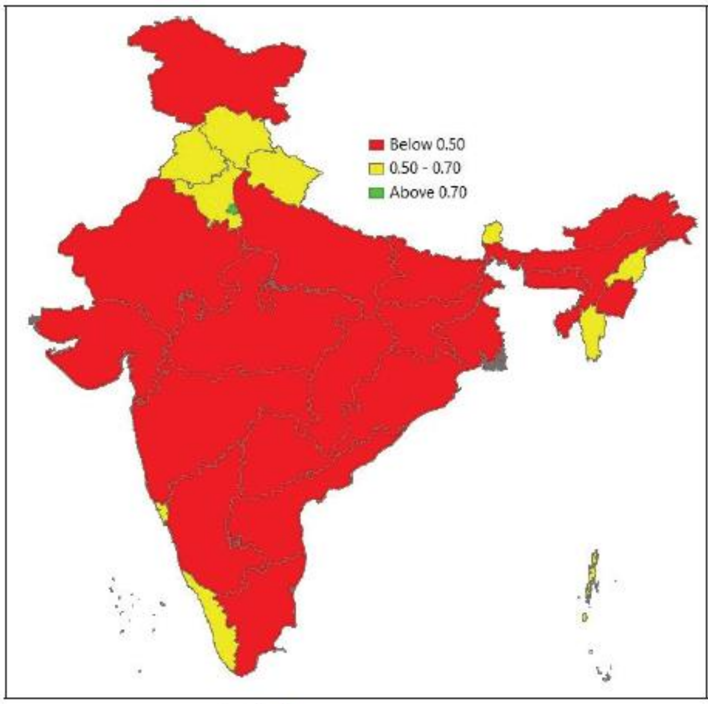


Pan-India BNI (Urban + Rural in 2018)

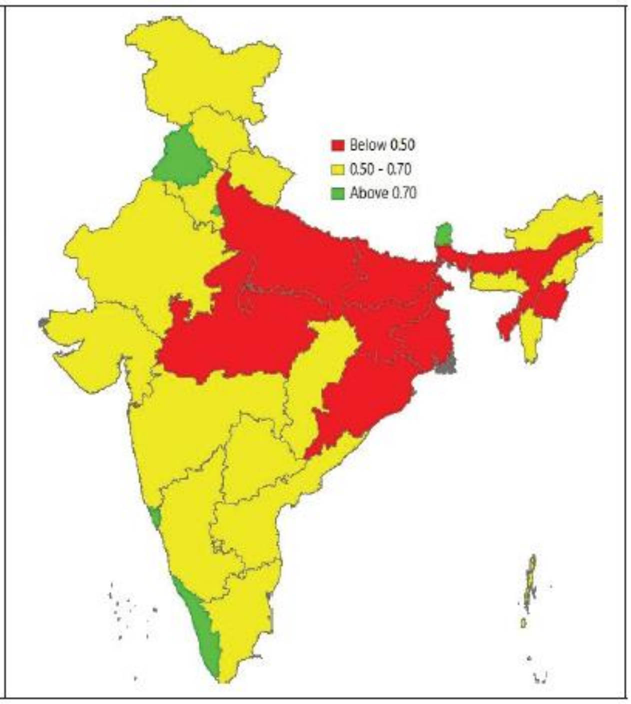


Source: Economic Survey 2020-21

BNI for Rural India (2012)



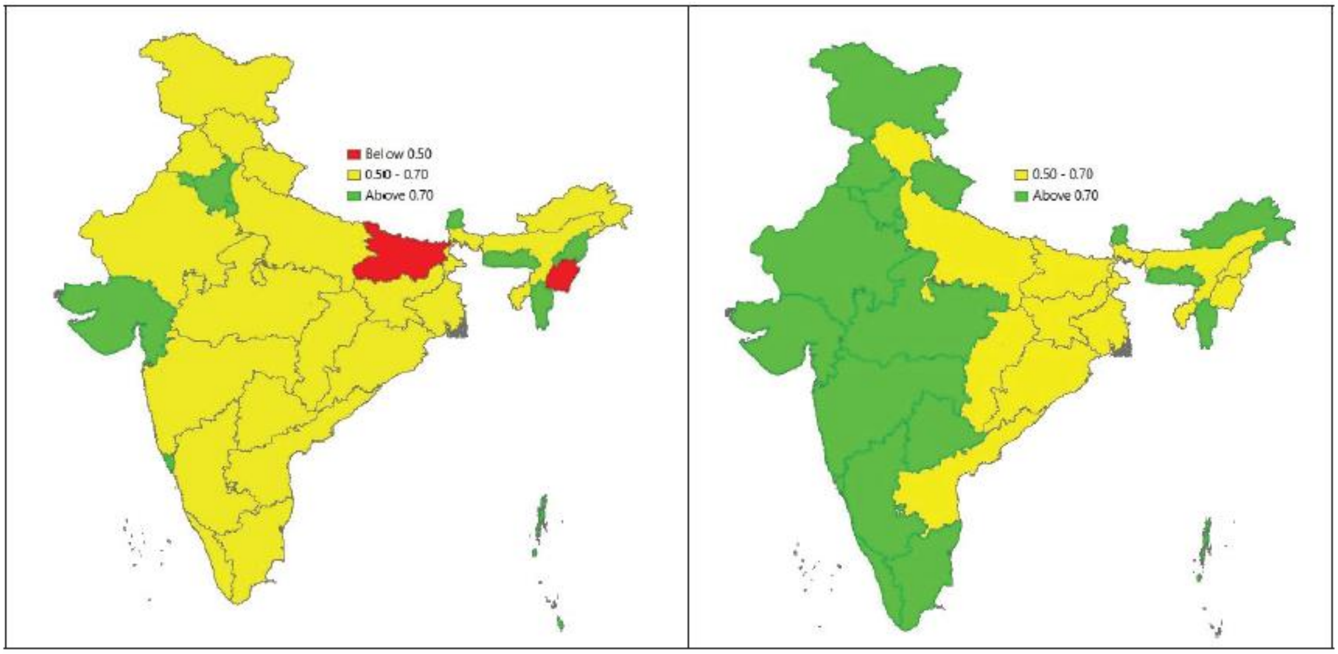
BNI for Rural India (2018)



Source: Economic Survey 2020-21

BNI for Urban India (2012)

BNI for Urban India (2018)



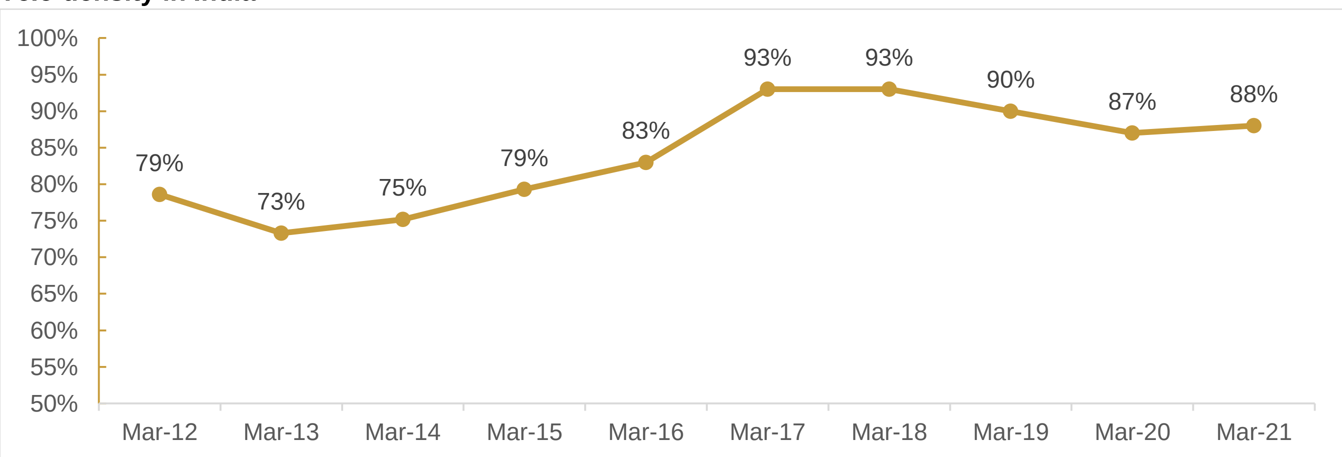
Source: Economic Survey 2020-21

Digitisation: Catalyst for the next growth cycle

Technology is expected to play a pivotal role in taking the financial sector to the next level of growth, by helping surmount the challenges stemming from India's vast geography, which makes physical footprints in smaller locations commercially unviable. Technology is conducive for India, considering its demographic structure where the median age is less than 30 years. The young population is tech savvy and at ease with using it to conduct the entire gamut of financial transactions. With increasing smartphone penetration and faster data speeds, consumers are now encouraging digitisation as they find it more convenient. Digitisation will help improve efficiency and optimise cost. Players with better mobile and digital platforms will draw more customers and emerge as winners in the long term.

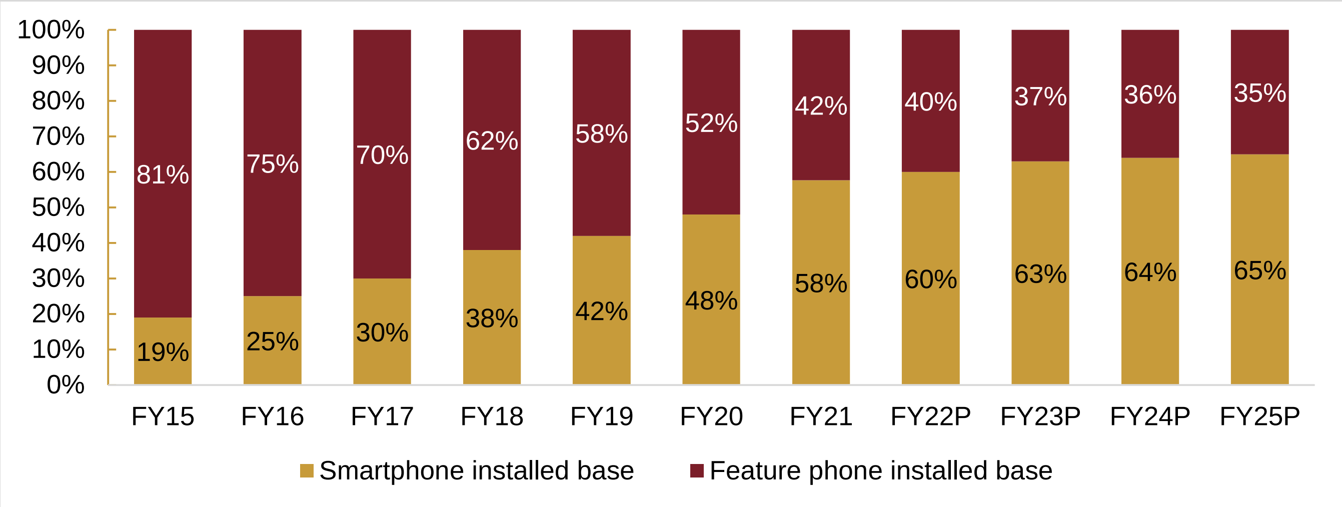
Mobile penetration: Higher mobile penetration, improved connectivity and faster and cheaper data speed, supported by Aadhaar and bank account penetration have led India to shift from being a cash-dominated economy to a digital one.

Tele-density in India



Source: TRAI, CRISIL Research

Data-savvy and younger users to drive adoption of smartphones



Note: P: Projected

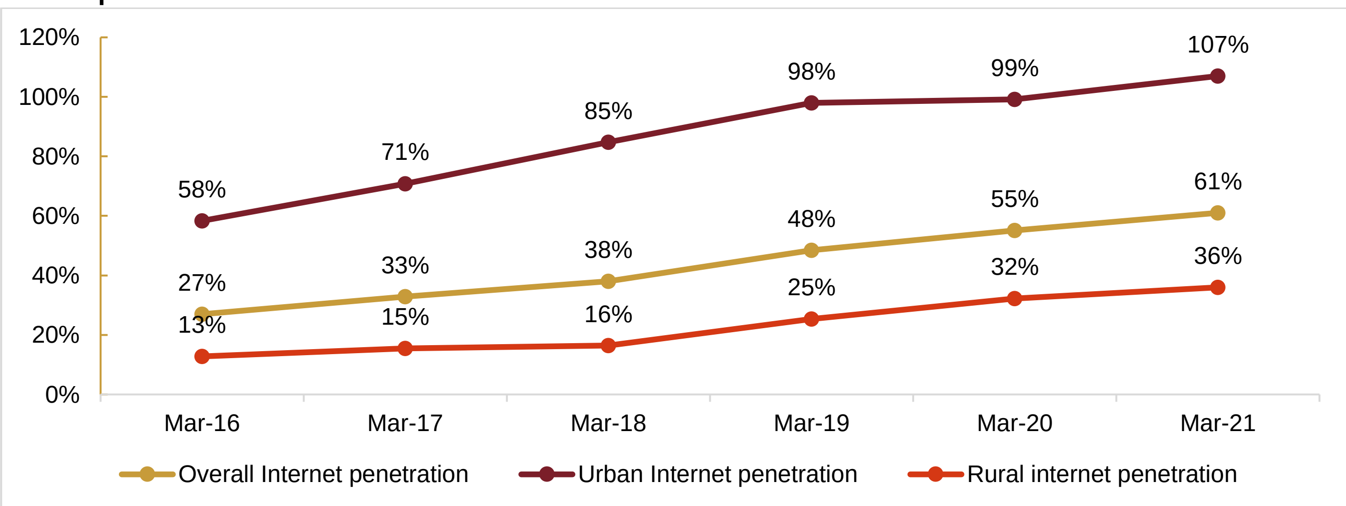
Source: CRISIL Research

Internet penetration: India has witnessed a dramatic surge in internet users over the past few years with internet penetration as a percentage of total population touching ~60% as of fiscal 2021 compared to less than 30% in fiscal 2016. This growth has largely been fuelled by the availability of smartphones at cheaper price points and availability of 4G connectivity at affordable prices.

CRISIL Research expects the total number of internet subscribers in the country to reach 1000 million by fiscal 2025 from 795 million as of December 2020, resulting in ~75% internet penetration. By 2025, complete transition of 2G and 3G data services to 4G is expected. This can be attributed to increased demand for data, competitive pricing of 4G services and availability of affordable handsets.

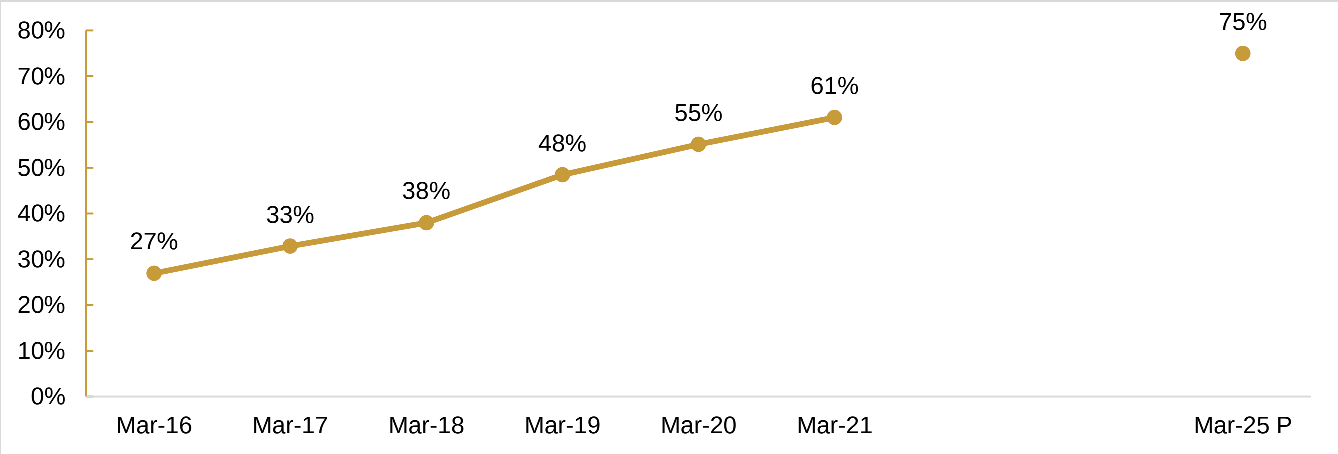
While internet penetration in urban areas have crossed 100%, in rural areas, the penetration is still below 40%. Nonetheless, the number of data subscribers in rural areas have almost tripled to 308 million subscribers as of December 2020 compared to 111 million subscribers as of March 2016 (Source: TRAI).

Internet penetration continues to increase



Source: TRAI, CRISIL Research

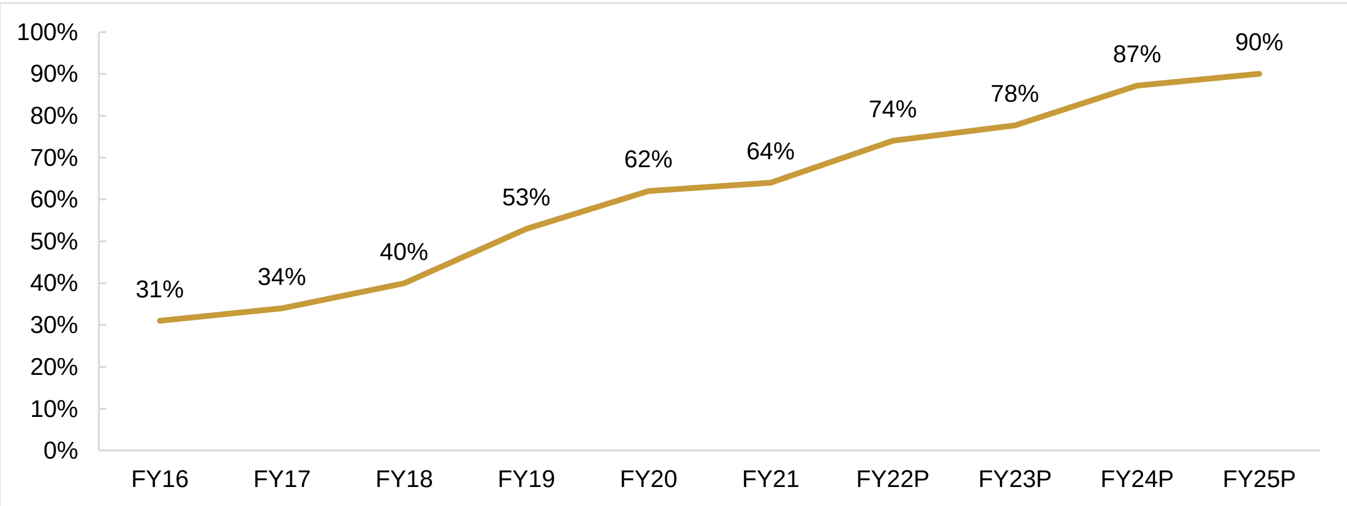
Overall Internet penetration to reach 75% by fiscal 2025



Note: P- Projected

Source: TRAI, CRISIL Research

Data subscribers as a proportion of wireless subscribers to increase significantly through FY25



Note: P: Projected

Source: Telecom Regulatory Authority of India (TRAI), CRISIL Research

Rise in 4G penetration and smartphone usage

The digital revolution has paved the way for digital payments. India had 1,181 million wireless subscribers as of March 31, 2021, and the number is growing at a steady pace every year. The reach of mobile network, internet and electricity is also expanding the digital payments footprint to remote areas. This is likely to increase the number of digital payment transactions. However, in semi urban and rural areas, internet, 4G and smartphone penetration is still lower compared to urban areas

All-India mobile and data subscriber base

	FY16	FY17	FY18	FY19	FY20	FY21P	FY22P	FY23P	FY24P	FY25P

Wireless subscribers (million)	1034	1170	1183	1162	1157	1181	1178	1191	1195	1203
Data subscribers (million)	322	401	473	615	720	756	*860*	*925*	*1042*	*1077*
Data subscribers as a proportion of wireless subscribers	31%	34%	40%	53%	62%	64%	74%	78%	87%	90%
4G data subscribers (million)	8	131	287	478	645	719	842	901	1022	1070
4G data subscribers proportion	2%	33%	61%	78%	90%	95%	98%	97%	98%	99%

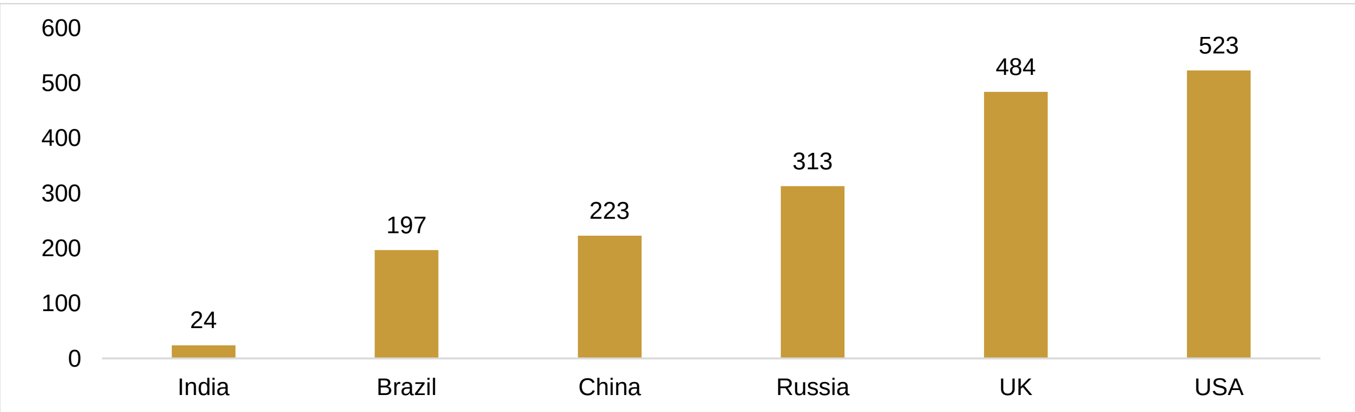
Note: P: Projected

Source: TRAI, CRISIL Research

Mobile data consumption in India has grown ~25 times in the past five fiscals at a CAGR of ~90%. The proportion of data subscribers is hence expected to rise to ~90% in fiscal 2025 from ~62% at FY 20. India's 4G data rates are among the lowest in the world. So, a combination of affordable handsets, growing consumer preference for data on the go and affordable data tariffs are set to accelerate the adoption of wireless internet in India, leading to a 4G data subscriber proportion at ~100%.

Digital payments and per capita transactions in India are among the lowest compared with similar countries. The government has taken multiple initiatives to give a boost to digitalisation in the country. This includes biometric identification of all Indian citizens through the Aadhaar programme, financial inclusion through the 'Jan Dhan Yojana', launch of Aadhaar-enabled payment systems, and push to online tax filings. UPI, which is based on the immediate payment service or IMPS platform, allows a user to transfer money from one bank account to another bank account instantly, and is seen as the next big leap in digital payments. Recent initiatives aimed at addressing the structural issues around lending requirement including GST filings, government launched UPI 2.0.

Number of non-cash payments transactions per capita, per annum (CY 2019)



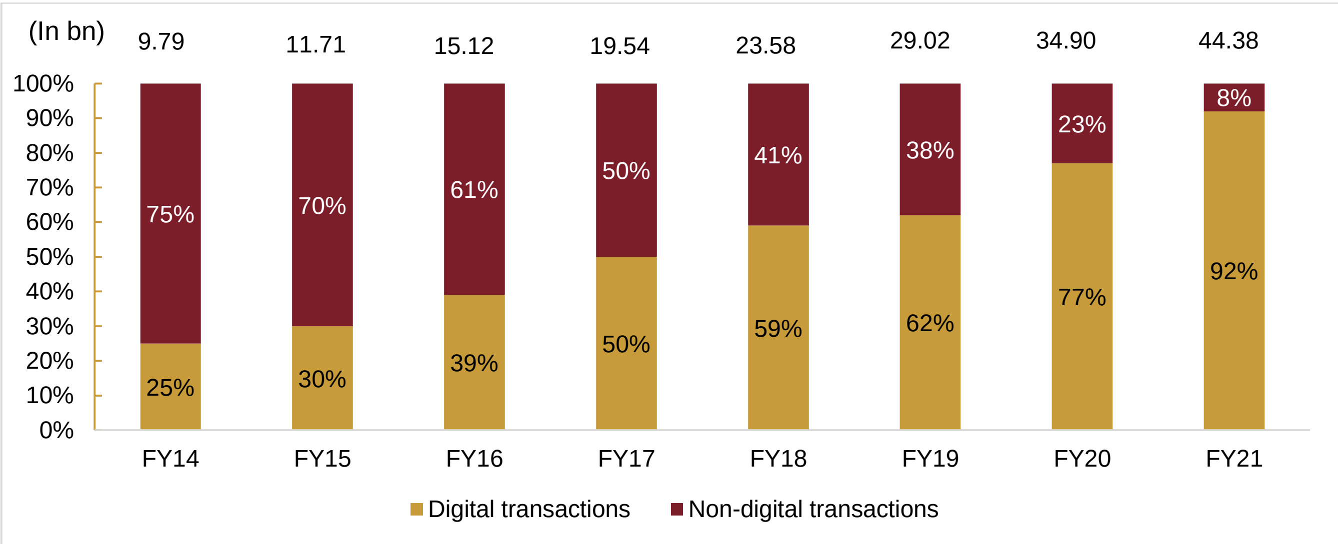
Source: Bank of International Settlements, CRISIL Research

Consumers are increasingly finding transacting through mobile convenient. CRISIL Research expects the share of mobile banking and prepaid payment instruments to increase dramatically over the coming years. In addition, CRISIL Research expects improved data connectivity, low digital payment penetration and proactive government measures to drive digitalisation in the country, transforming it into a cashless economy.

Increasing share of digital channels in domestic monetary transactions

The share of different channels in domestic money transfer has changed significantly over the past five years. Banks, for example, are witnessing a change in customer behaviour with fewer customers visiting bank branches for transactions. This change in behaviour was led by demonetisation when cash transactions slowed down, many new accounts were opened and digital banking witnessed a surge in use and continued its growth trajectory. The preference has also shifted from cost factors to convenience and ease of performing transactions, which helps in saving time spent in queues, not disturbing the daily working hours and avoiding any potential monetary loss.

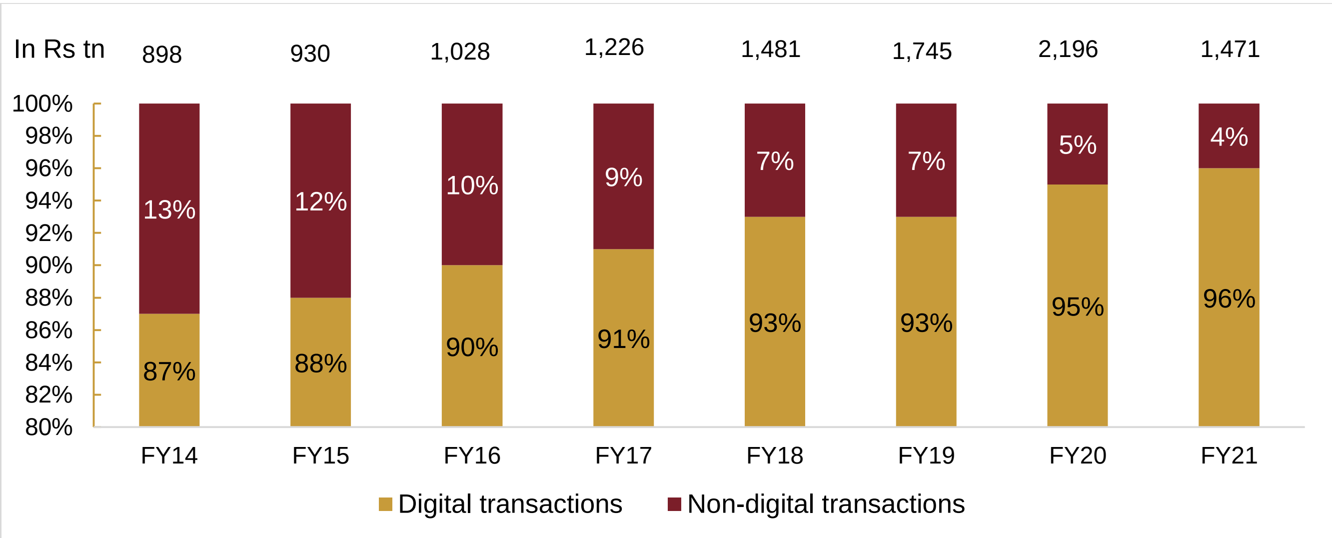
Transactions in volume terms



Note: P: Projected; Digital transactions includes RTGS – excluding interbank clearing, ECS, NEFT, IMPS, NACH, cards and prepaid instruments; Non-digital transactions include cheques/paper clearing and ATM transactions. Amount above each bar indicates volume of transactions in the year.

Source: RBI, CRISIL Research

Transactions in value terms



Note: P: Projected; Digital transactions includes RTGS – excluding interbank clearing, ECS, NEFT, IMPS, NACH, cards and prepaid instruments; Non-digital transactions include cheques/paper clearing and ATM transactions Amount above each bar indicates value of transactions in the year.

Source: RBI, CRISIL Research

Financial Inclusion

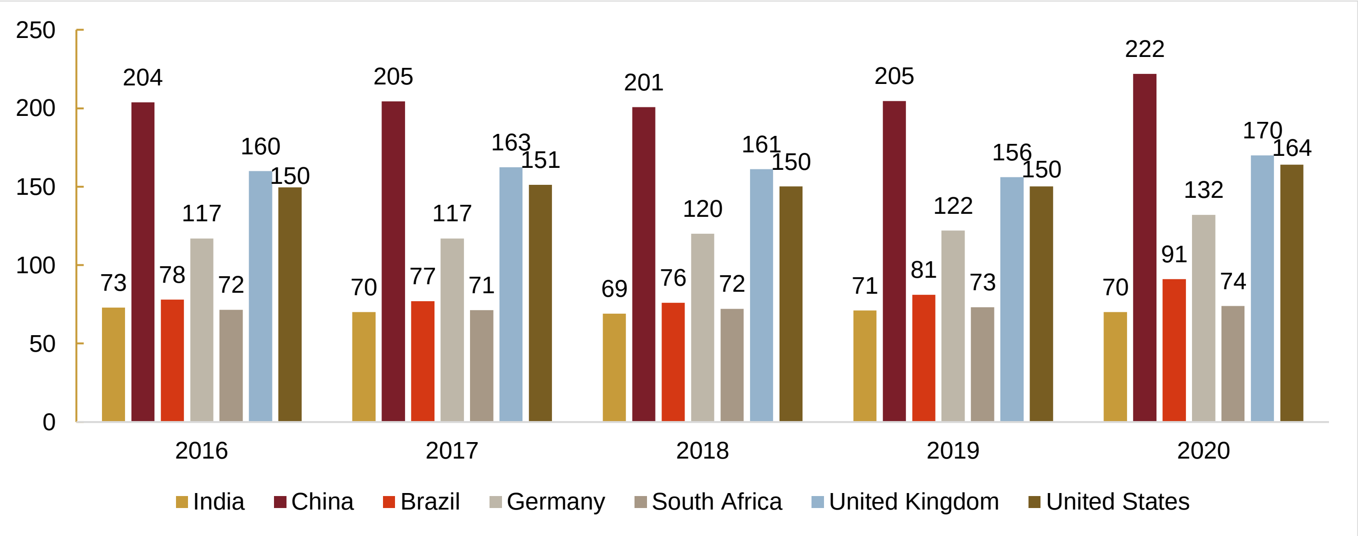
Current scenario and key developments

The COVID-19 pandemic has spread across the world, and India is no exception. The lockdown of nearly 1.3 billion people and a large number of businesses led to disruption and dislocation on a scale never imagined. It slammed the brakes on economic activity and caused enormous human suffering. Nonetheless, with opening of lockdown and businesses restarting, economy is on the path of recovery.

In these unprecedented times, to provide some relief to the customers, the RBI had introduced measures that permits lending institutions to allow a moratorium of six months on repayment of instalments for term loans outstanding as on March 1, 2020. Lending institutions were permitted to defer interest payments on working capital facilities outstanding as on March 1, 2020, by a period of six months which ended on August 31, 2020. However, lending institutions were instructed to provide 10% additional provisioning for on all loans that are overdue but not NPAs (non-performing assets) wherein the moratorium is approved, which could be later adjusted against the provisioning requirements for actual slippage. These measures were required to boost confidence in the economy.

In these times of crisis, financial inclusion as also access to finance becomes more imperative than ever for vulnerable households and businesses to navigate the crises and recover after the pandemic. In terms of the credit to GDP ratio, India has a low credit penetration compared with other developing countries, such as China indicating that the existing gap needs to be bridged. Similarly, in terms of credit to households as a proportion of GDP as well, India lags other markets, with retail credit hovering at around 22% of GDP as of fiscal 2020.

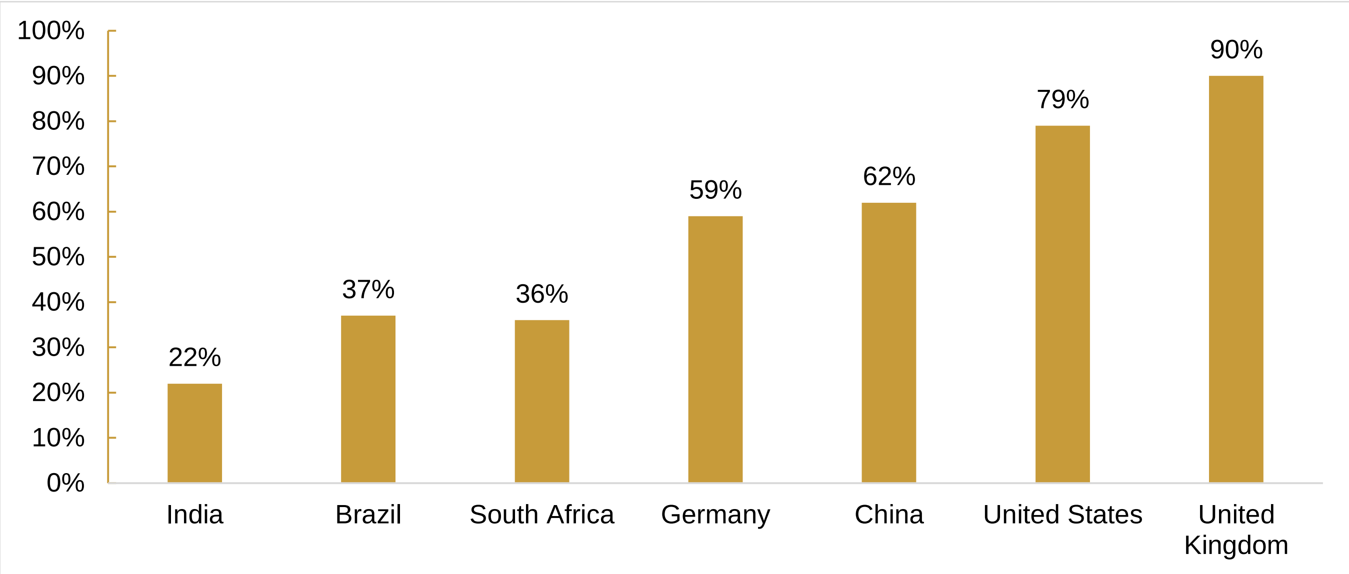
Credit to GDP ratio (%)



Note: Data is represented for calendar years for all countries except India. For India, numbers are for fiscal year

Source: Bank of International Settlements, CRISIL Research

Retail Credit to GDP ratio (2020)

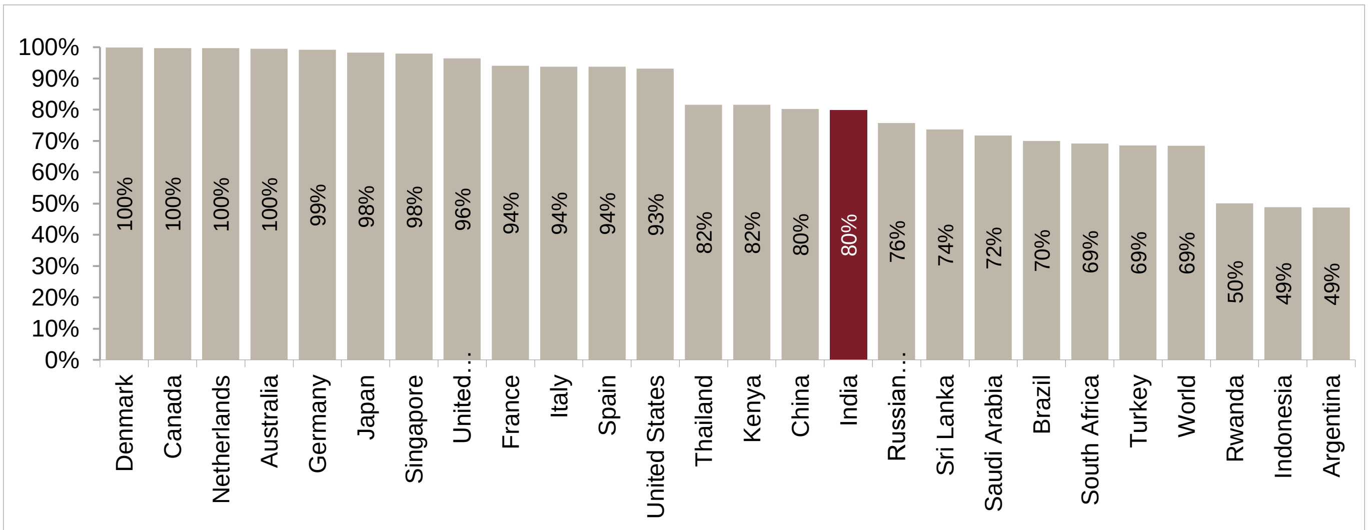


Note: For countries except India, data is represented for calendar years. For India, data represented is for fiscal year 2021.

India's focus on financial inclusion is increasing; however, a large section of the population is still unbanked

According to the World Bank's Global Findex Database 2017, the global average of adult population with an account (with a bank, financial institution, or mobile money providers) was about 69% in 2017. India's financial inclusion has improved significantly in the past three years, with the adult population with bank accounts rising from 53% (as per Global Findex Database 2014) to 80% (in 2017) with concentrated efforts from the government and the rise of various supporting institutions. Although the rise in the number of bank accounts has not translated into a corresponding increase in the number of transactions and fruitful usage of those accounts.

Adult population with a bank account (%): India vis-à-vis other countries

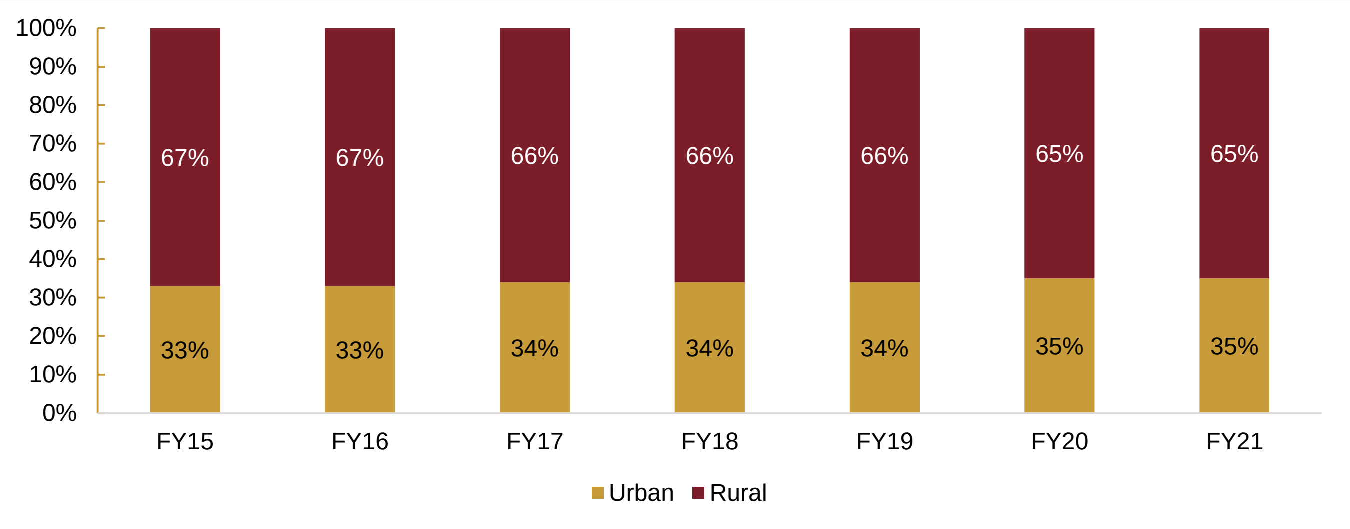


Note: 1. Global Findex data for India excludes northeast states, remote islands and selected districts. 2. Account penetration is for the population within the age group of 15+

Source: World Bank - The Global Findex Database 2017, CRISIL Research

The low levels of adults with bank accounts in comparison with various countries can be further explained by the large number of rural households in the country, which account for nearly two-thirds of the total households in the country. The shift in households towards urban regions is taking place albeit at a very slow pace.

Two-thirds of total households are in rural India



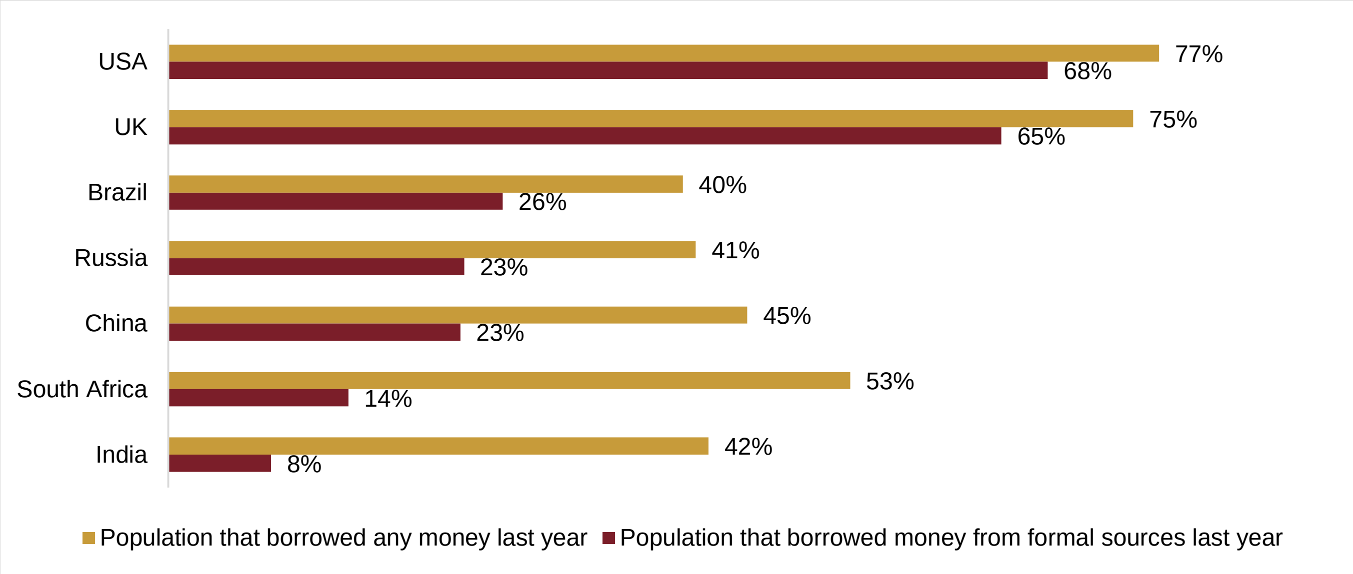
Source: World Bank; Census; CRISIL Research

Although the majority of Indian households are located in the rural region, the banking infrastructure in these regions is relatively inferior and, thus, there is a gap in the supply and demand of financial services in the backward regions of the country, which is a pocket of opportunity for the financial services sector.

Financial exclusion is widely prevalent in countries, such as India, due to poverty and low income, financial illiteracy, high transaction costs, and lack of infrastructure (primarily information technology). Consequently, a significant proportion of the population still lacks access to formal banking facilities. According to NABARD All India Rural Financial Inclusion Survey 2016-17, 40% loans were reported as taken from non-institutional investors or informal channels like relative and friends, money lenders and local landlords.

According to the World Bank's Global Findex Database 2017, only 8% of the Indian population borrowed money through a formal channel like financial institutions which is very low compared to other developed and developing countries.

Only 8% of India's population borrowed money from formal sources



Note: 1. Global Findex data for India excludes northeast states, remote islands and selected districts. 2. Data is for the population within the age group of 15+

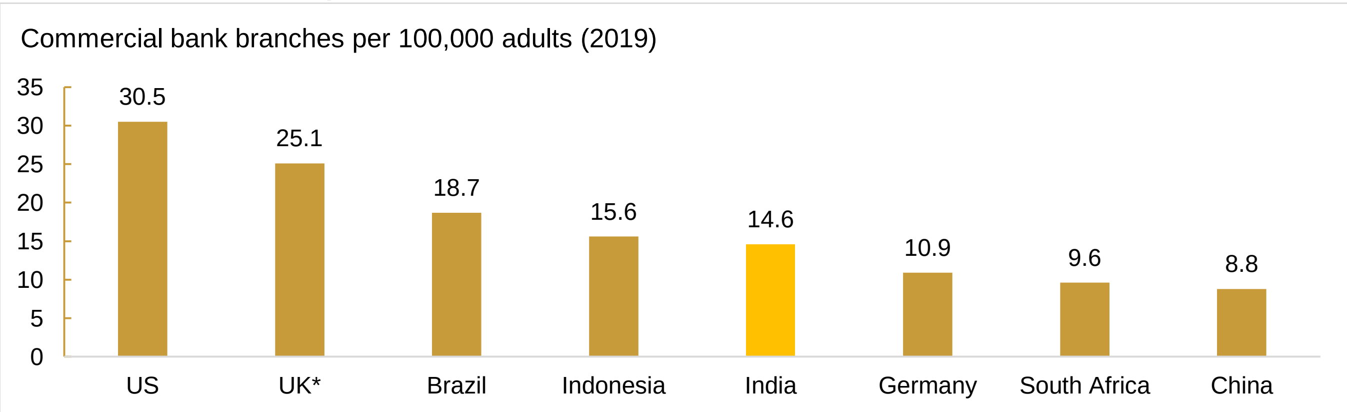
3. Money borrowed from formal sources includes money borrowed from Banks, NBFCs and usage of credit card

Source: World Bank - The Global Findex Database 2017, CRISIL Research

To tackle financial exclusion, the Indian government introduced the PMJDY, a scheme that facilitates opening bank accounts by the unbanked. However, the effective use of these new accounts, increase in the number of transactions in these accounts and availability of credit remain key challenges, which need to be effectively addressed as borrowings from the formal sources still remains low.

India is one of the countries with lower commercial bank branches and ATM penetration indicating huge room for financial inclusion and banking services penetration. As of calendar year 2019, India has 14.6 branches and 21 ATMs for one lakh adults according to World Bank data which is relatively lower than other developing and developed countries.

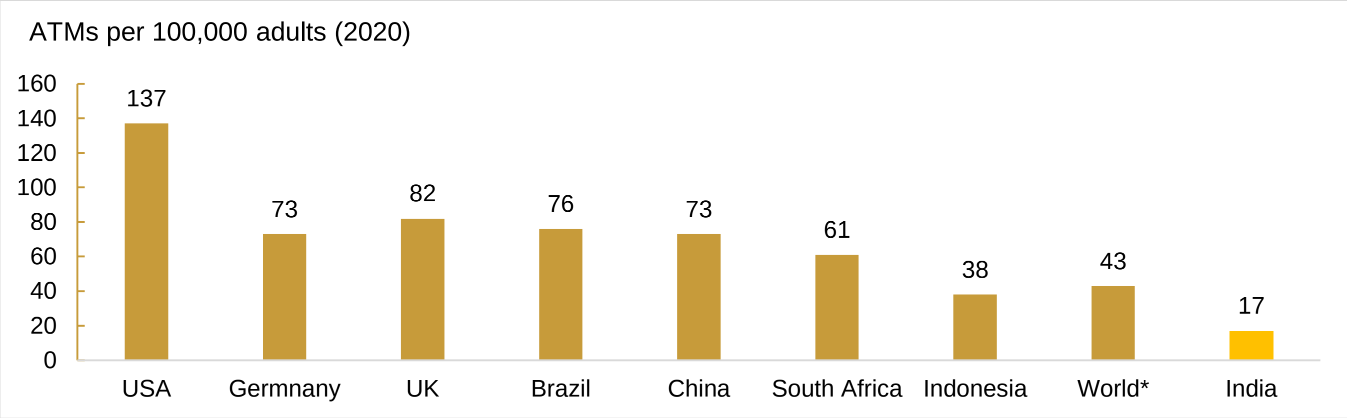
Commercial bank branch penetration across the world



Note: (*) – UK data is as of 2013 calendar year

Source: World Bank, RBI, CRISIL Research

ATM penetration across the world



*Note: * Data for 2019*

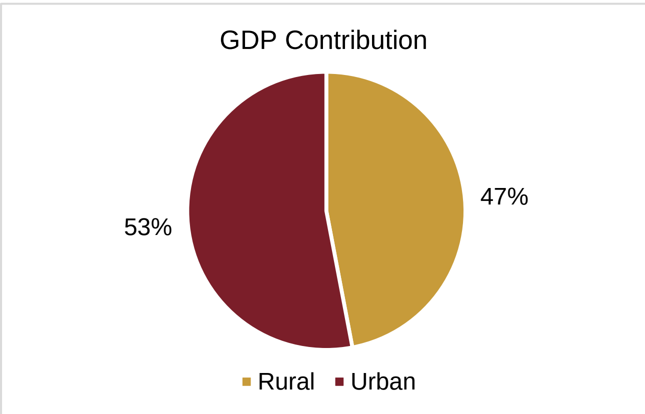
Source: Company Reports, IMF, World Bank, BIS, RBI, House of Commons Library UK, European Association of Secured Transactions (EAST), CRISIL Research

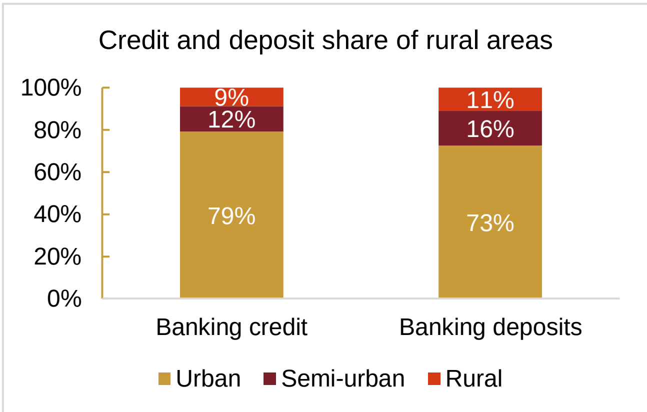
Rural India accounts for about half of GDP, but only about 9% of total credit and 11% of total deposits

According to Census 2011, there are about 640,000 villages in India, which are inhabited by about 893 million people, comprising about 66% of the country's population as of March 31, 2021. About 47% of India's GDP comes from rural areas. The share of total credit outstanding is about 9% in rural areas and 91% in urban areas as of March 31, 2021. The massive divergence in the rural areas' share of India's GDP and banking credit services compared with urban areas is an indicator of the extremely low penetration of banks in rural areas.

The chart below shows the percentage of GDP contribution and credit outstanding in rural and urban areas**:**

Low share of banking credit and deposit indicates lower penetration in rural areas (as of March 2021)



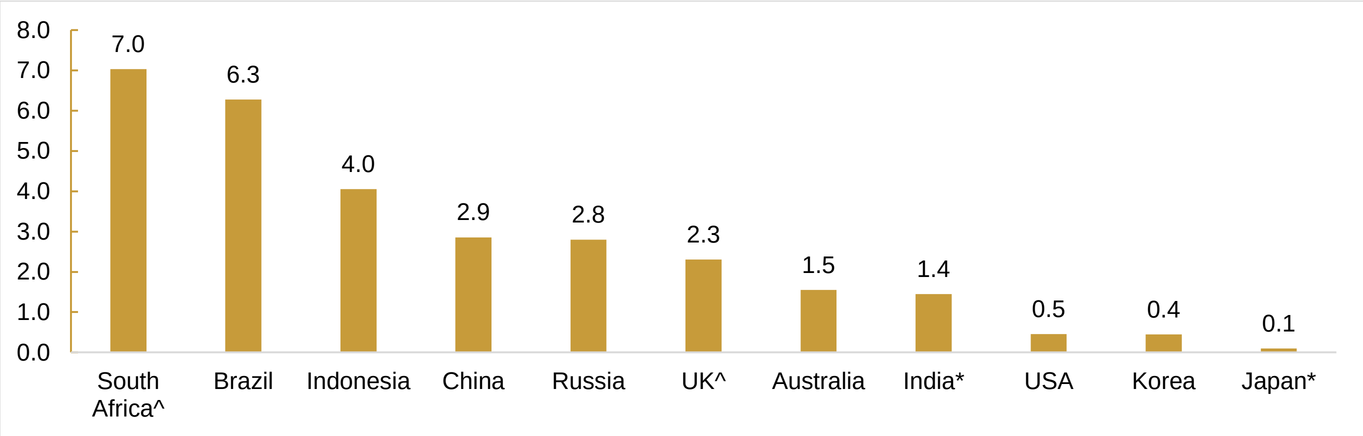


Source: CSO; RBI; CRISIL Research estimates (for GDP contribution as per 2017)

As rural areas in India have lower financial inclusion compared with urban areas and there is less competition for banking services in rural areas compared with urban areas, this presents significant growth opportunities in rural areas.

India's ATM withdrawal to Cash-in-circulation ratio lies behind other countries indicating lower debit card penetration is in the country. However, with initiatives like PMJDY focussed towards increasing financial penetration and inclusion, the government has been attempting to change the situation. Under PMJDY, the beneficiaries have been issued RuPay debit cards which has also been a key enabler from rural participation in financial system. As of March 31, 2021, 309 million RuPay debit cards have been issued to 422 million PMJDY beneficiaries. Out of these, 66% of the beneficiaries belong to rural and semi-urban areas.

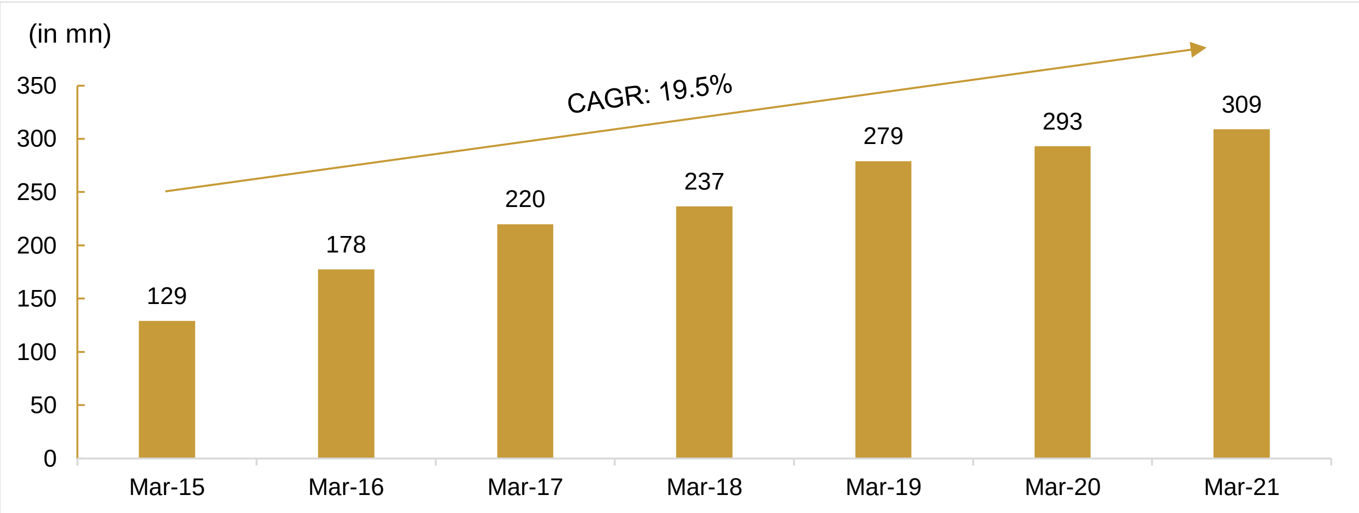
ATM withdrawal to CIC (Cash in circulation) ratio



Note: (*) Data as of end of March 2020 is used for CIC and data for 2019 is used for ATM withdrawals, (^) Data as of end of February of next calendar year is used for CIC data for 2019 is used for ATM withdrawals

Source: Bank of International Settlements, CRISIL Research

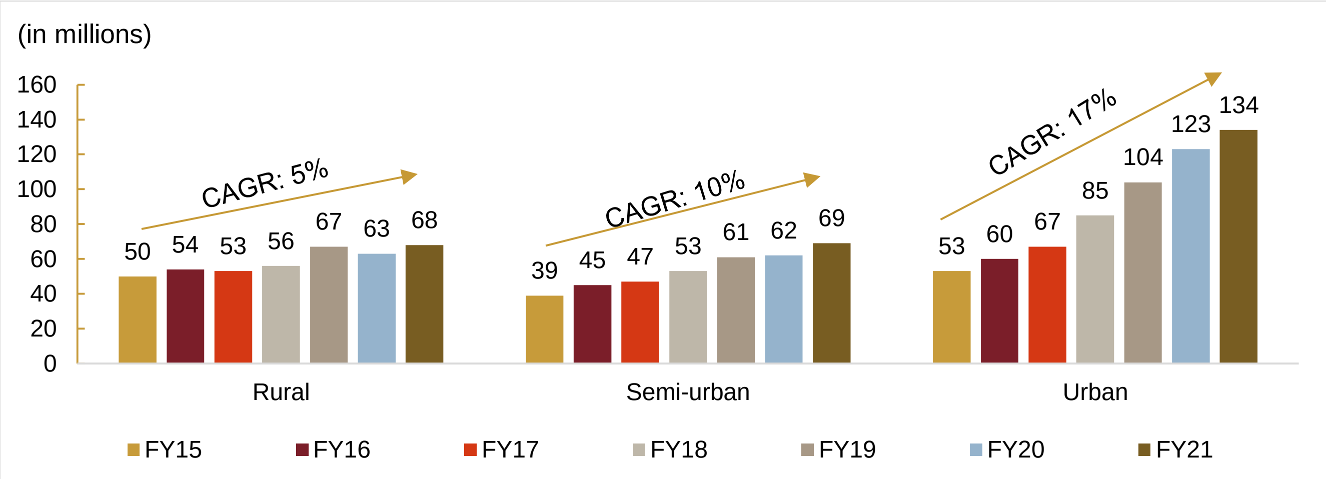
Number of RuPay debit cards issues under PMJDY



Source: PMJDY, CRISIL Research

The number of bank credit accounts in rural areas grew at a CAGR of 5% between the end of Fiscal 2015 and the end of Fiscal 2021 and the number of bank deposit accounts grew at a CAGR of 7% between the end of Fiscal 2015 and the end of Fiscal 2020. However, with payments bank increasing their reach and expanding into rural areas and increasing financial awareness, faster growth in rural areas can be expected in the future given the huge untapped potential. Between the end of Fiscal 2015 and the end of Fiscal 2021, the number of credit accounts in semi-urban areas grew at a CAGR of 10% and between the end of Fiscal 2015 and the end of Fiscal 2020, the number of deposit accounts grew at a CAGR of 9%. Between the end of Fiscal 2015 and Fiscal 2021, the number of credit accounts in urban areas grew at a CAGR of 17% and between the end of Fiscal 2015 and the end of Fiscal 2020, the number of deposit accounts grew at a CAGR of 7%.

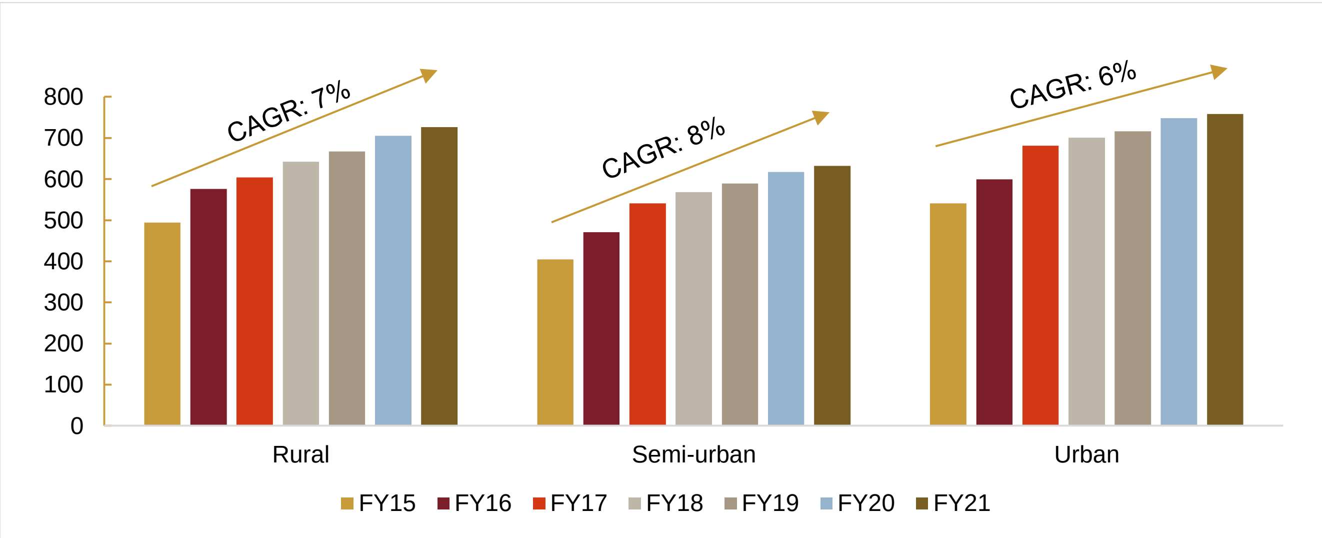
Bank credit accounts in rural, semi-urban and urban areas (FY21)



Note: Urban includes data for Urban and Metropolitan areas; amounts are as of the end of the fiscal year indicated. Data represents only bank credit accounts

Source: RBI; CRISIL Research

Bank deposit accounts in rural, semi-urban and urban areas (FY21)



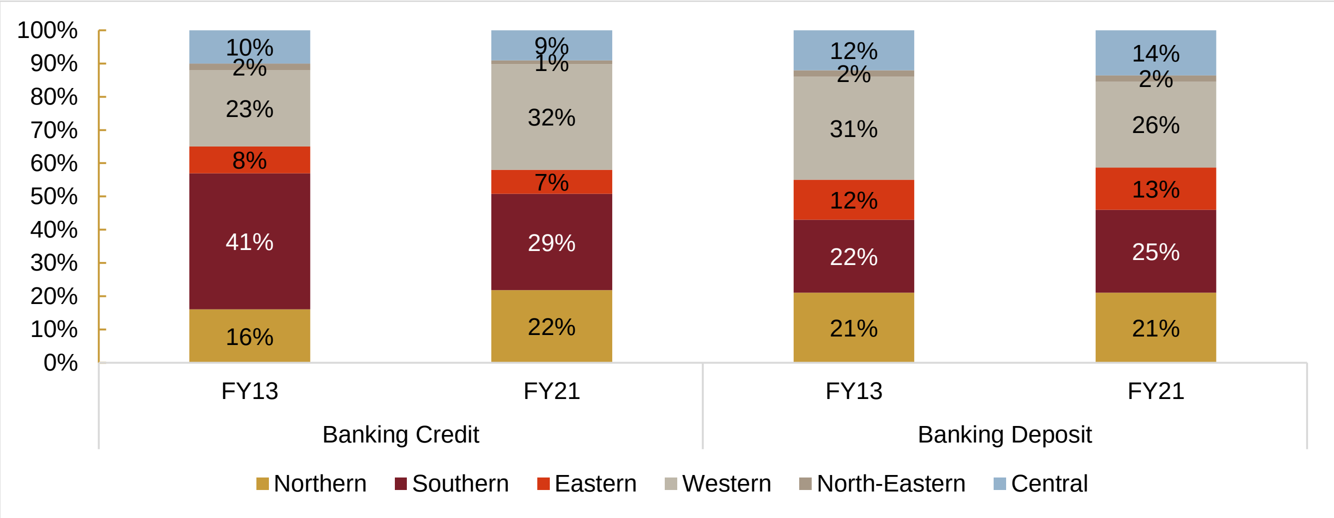
Note: Urban includes data for Urban and Metropolitan areas; amounts are as of the end of the fiscal year indicated. Data represents only bank deposit accounts

Source: RBI; CRISIL Research

Region-wise asymmetry: Central and eastern regions have a lower share in total bank credit and deposits

Bank credit and deposits are predominantly concentrated in the southern and western regions, whereas they have been especially low in the north-eastern and eastern regions. Deposit penetration in the southern region has increased over the past eight fiscal years by 7%.

Region-wise share of banking credit and total deposits

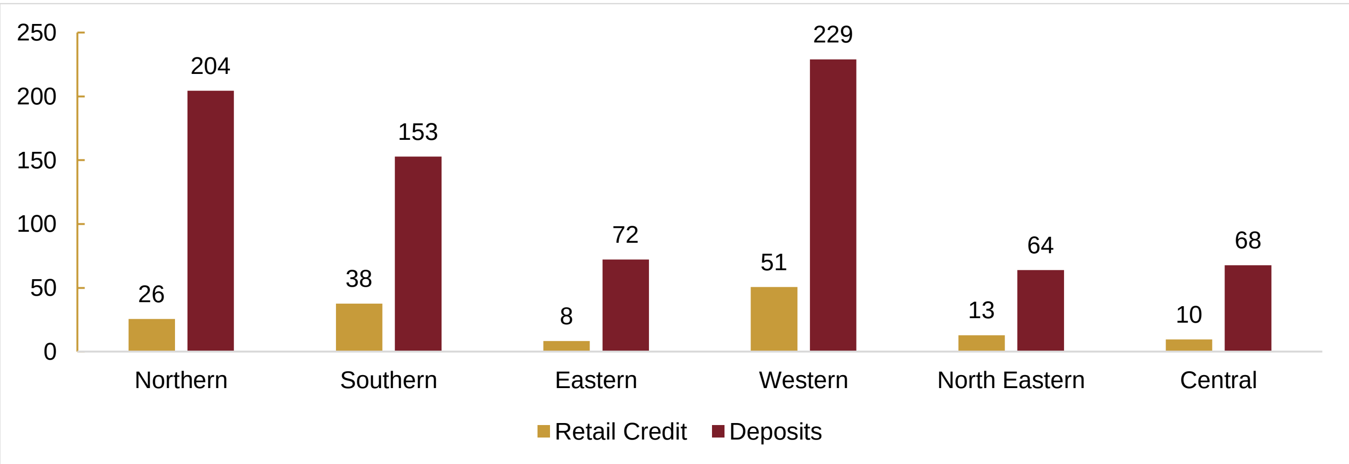


Note: The percentages are as of the end of the fiscal year indicated.

Source: RBI; CRISIL Research

Bank retail credit per capita in the east is the lowest and is nearly five times lower than in the south and west. Low per-capita retail credit as well as deposits in eastern, central, and north-eastern regions compared with other regions implies low penetration of banks in these areas. This provides an opportunity for all lending and deposit accepting institutions to expand in these regions and also expand their reach in specific areas around them. In terms of deposits, the southern region is moderately penetrated compared with the northern and western regions, leaving a lot of headroom for growth for the players to capitalise on.

Region-wise per capita* banking retail credit and deposits as of the end of FY21 (Rs. in thousands)

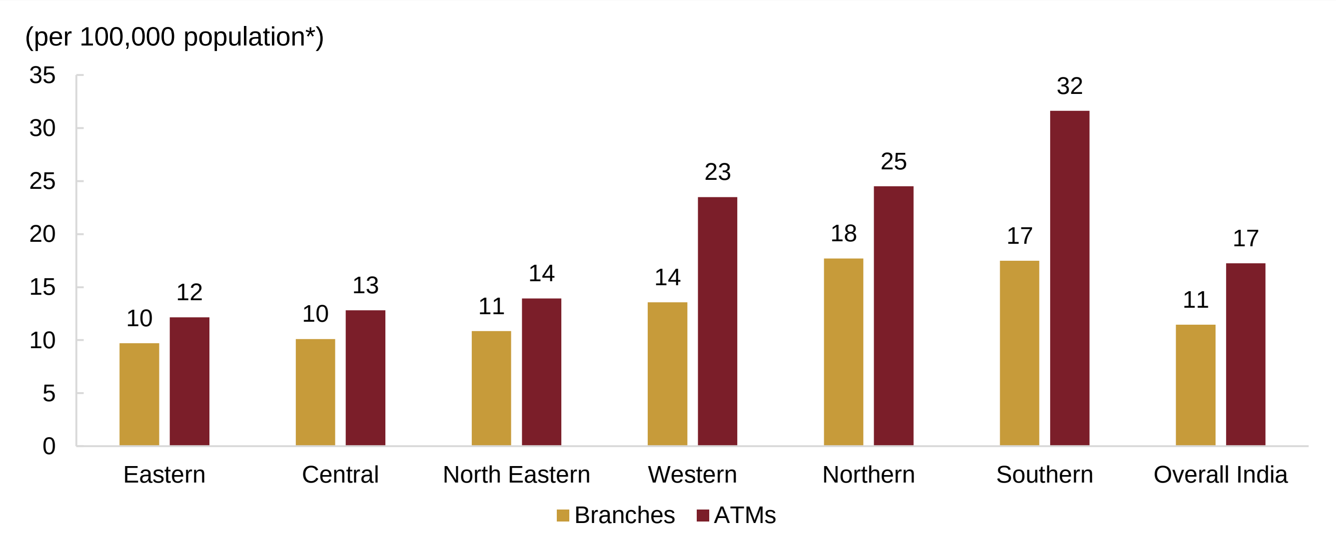


Note: '' population as per the census data of 2011*

Source: RBI; Census India; CRISIL Research

The number of branches and ATM facilities in the eastern regions, where credit penetration and deposit-base are low is also below those of the southern and western regions, which CRISIL Research believes is largely due to lower focus from the bigger banks.

Region-wise presence of bank ATM and branches (as of March 31, 2021)



Note: '' population is as per the census data of 2011*

Source: RBI; Census India; CRISIL Research

Large variation in credit availability across states and districts

There is a wide variation across states and within various districts in the same state as well in terms of credit, which indicates latent opportunity for providing banking services to unserved or underserved customers. Uttar Pradesh and Bihar are the most populous states in India, accounting for 16% and 9% respectively of overall population in India, as compared to other states like Assam, Jharkhand and Odisha with share of ~3%. Based on bank credit accounts in rural areas, Himachal Pradesh, Odisha, Jharkhand and Bihar have more than 45% of the credit accounts in rural areas compared to Maharashtra, Delhi, Kerala and Mizoram where the share of accounts in rural areas is below 10%. In value terms, bigger states like Maharashtra, Delhi, Kerala and Gujarat have less than 10% of credit outstanding in rural areas compared to Meghalaya, Himachal Pradesh and Jammu & Kashmir with more than 30% of rural credit outstanding.

Maharashtra and Delhi, among the states with high share in overall credit, have more than 70% of total credit outstanding concentrated in the top five districts as of FY21.

State-wise rural credit accounts in banks and top five districts concentration (FY21)

State	No. of districts	% share in overall population in India	Share in overall credit	Credit to Deposit ratio (FY19)	Concentration of credit in top 5 districts	% of credit in rural areas	Concentration of credit accounts in top 5 districts*	% credit accounts in rural areas
Maharashtra	99	9%	29%	95%	90%	2%	73%	8%
Delhi	4	1%	13%	94%	100%	0%	100%	0%
Tamil Nadu	88	6%	10%	102%	62%	11%	44%	26%
Karnataka	83	5%	7%	61%	74%	8%	44%	28%

Gujarat	92	5%	6%	69%	72%	6%	51%	17%
Uttar Pradesh	207	16%	5%	41%	37%	17%	18%	36%
Andhra Pradesh	62	8%	4%	129%	64%	15%	45%	30%
West Bengal	40	7%	4%	46%	73%	13%	46%	45%
Kerala	37	3%	4%	62%	66%	2%	52%	4%
Rajasthan	90	6%	3%	77%	53%	14%	39%	32%
Madhya Pradesh	135	6%	3%	67%	54%	11%	33%	26%
Haryana	62	2%	3%	52%	62%	9%	43%	20%
Punjab	60	2%	2%	54%	60%	21%	47%	29%
Bihar	99	9%	1%	39%	46%	22%	36%	46%
Odisha	69	3%	1%	39%	60%	20%	47%	50%
Chhattisgarh	64	2%	1%	62%	73%	8%	47%	21%
Assam	69	3%	1%	47%	50%	25%	35%	46%
Jharkhand	56	3%	1%	30%	67%	17%	53%	46%
Jammu and Kashmir	43	1%	1%	31%	60%	34%	50%	50%
Uttarakhand	28	1%	1%	35%	89%	21%	81%	31%
Himachal Pradesh	22	1%	0%	31%	74%	57%	67%	69%
Goa	4	0%	0%	24%	100%	16%	100%	30%
Tripura	16	0%	0%	41%	87%	28%	83%	35%
Meghalaya	20	0%	0%	37%	93%	30%	88%	42%
Manipur	25	0%	0%	56%	83%	28%	79%	29%
Nagaland	21	0%	0%	39%	87%	21%	82%	25%
Arunachal Pradesh	30	0%	0%	24%	74%	25%	65%	31%
Sikkim	20	0%	0%	34%	100%	28%	81%	39%
Mizoram	7	0%	0%	43%	85%	7%	100%	7%

Note: Arranged in descending order of share in overall credit outstanding of banks, (*) As of FY20

Source: RBI, CRISIL Research

Similarly in terms of bank deposits, Odisha, Jharkhand, Assam, Himachal Pradesh, Sikkim and Meghalaya have more than 50% of the deposit accounts in rural areas compared to Maharashtra, Delhi and Kerala where the share of accounts in rural areas is below 20%. In value terms, Maharashtra, Delhi, Kerala, Karnataka, Tamil Nadu and Haryana have less than 10% of deposits in rural areas compared to Sikkim, Tripura, Meghalaya, Arunachal Pradesh, Himachal Pradesh and Jammu & Kashmir with more than 25% of rural deposits.

Maharashtra and Karnataka, among the bigger states have more than 75% of total deposits concentrated in the top five districts as of FY21.

State-wise rural deposit accounts in banks and top five districts concentration (FY21)

State	No. of districts	% share in overall population in India	% Share in overall deposits	Concentration of deposits in top 5 districts	% of deposits in rural areas	Concentration of deposit accounts in top 5 districts*	% deposit accounts in rural areas*
Maharashtra	35	9%	21%	85%	3%	52%	18%
Delhi	11	1%	10%	100%	1%	61%	2%
Uttar Pradesh	74	16%	9%	39%	20%	15%	46%
Karnataka	29	5%	8%	79%	7%	44%	30%
Tamil Nadu	32	6%	7%	66%	9%	35%	24%
West Bengal	23	8%	6%	69%	17%	38%	47%
Gujarat	46	7%	6%	61%	11%	42%	26%
Kerala	33	5%	4%	63%	3%	46%	4%
Haryana	14	3%	4%	67%	9%	39%	25%
Rajasthan	22	2%	3%	54%	15%	34%	37%
Punjab	32	6%	3%	56%	21%	46%	32%
Madhya Pradesh	22	2%	3%	51%	12%	23%	32%
Bihar	52	6%	3%	48%	23%	27%	48%
Odisha	38	9%	3%	57%	24%	33%	56%
Andhra Pradesh	30	3%	2%	62%	16%	32%	30%
Jharkhand	24	3%	2%	69%	18%	40%	52%
Chhattisgarh	33	3%	1%	64%	18%	37%	45%
Assam	28	2%	1%	59%	22%	27%	53%
Uttarakhand	13	1%	1%	85%	23%	71%	44%
Jammu and Kashmir	20	1%	1%	68%	28%	50%	50%
Himachal Pradesh	10	1%	1%	73%	61%	67%	74%
Goa	2	0%	1%	100%	23%	100%	34%
Tripura	8	0%	0%	91%	28%	81%	47%
Meghalaya	10	0%	0%	92%	26%	77%	54%
Arunachal Pradesh	13	0%	0%	77%	26%	66%	40%
Nagaland	7	0%	0%	95%	10%	94%	23%
Manipur	10	0%	0%	89%	25%	78%	38%
Mizoram	4	0%	0%	89%	13%	82%	30%
Sikkim	11	0%	0%	100%	28%	100%	51%

Note: Arranged in descending order of share in overall deposits. (*) Data as of FY20

Source: RBI, CRISIL Research

Karnataka, Telangana and Haryana registered fastest growth over Fiscals 2015-2020

GDP growth has been varied across states with Karnataka growing at the fastest rate of 9.9% CAGR (FY 2015-FY 2020), followed by Telangana (9.8%), Haryana (9.1%), Gujarat (8.7%) and Andhra Pradesh (8.6%). In the South, states like Andhra Pradesh, Karnataka and Tamil Nadu have huge headroom for growth given the credit penetration and economic growth. Similarly, In the West, states like Maharashtra and Gujarat have showcased good growth in terms of GDP and Gujarat has a relatively lower credit penetration, which provides a huge potential to be addressed.

State-wise GDP and GDP growth (FY 2021)

States	Real GDP Rs. Billion (FY 2020)	YOY growth	Real GDP growth CAGR (FY 2015-FY 2020)	Credit account penetration (FY 2021)	Deposit account penetration^	Branch penetration (FY 2021)	ATM penetration (FY 2021)	CRISIL Inclusix Score (FY2016)
Maharashtra*	20,391	6.0%	6.6%	32%	164%	108	211	62.7
Tamil Nadu	13,129	8.0%	8.0%	14%	182%	147	331	77.2
Karnataka	12,010	6.8%	9.9%	9%	190%	157	259	82.1
Uttar Pradesh	11,873	4.4%	7.3%	2%	175%	80	96	44.1
Gujarat*	11,864	9.2%	8.7%	7%	149%	126	175	62.4
West Bengal	7,932	7.3%	6.7%	3%	146%	90	120	53.7
Rajasthan	7,116	5.0%	6.4%	4%	123%	101	137	50.9
Andhra Pradesh	6,720	8.2%	8.6%	9%	167%	137	231	78.4
Delhi	6,344	7.4%	8.2%	25%	277%	197	422	86.1
Haryana	5,722	7.7%	9.1%	10%	187%	180	237	67.7
Madhya Pradesh	5,618	7.6%	7.9%	4%	133%	89	128	48.7
Kerala*	5,594	7.5%	6.7%	11%	200%	180	267	90.9
Punjab	4,189	5.3%	6.1%	9%	196%	212	232	70.9
Bihar	4,150	10.5%	8.2%	1%	114%	65	71	38.5
Odisha	4,024	5.3%	8.3%	4%	137%	113	157	63
Chhattisgarh	2,435	5.3%	5.6%	4%	140%	99	129	45.7
Jharkhand	2,400	6.7%	5.2%	3%	127%	86	97	48.2
Assam*	2,340	6.4%	8.1%	3%	124%	86	117	47.9
Uttarakhand*	1,933	6.9%	7.3%	5%	123%	193	239	69
Himachal Pradesh	1,244	5.6%	6.9%	5%	180%	217	242	72.3
Jammu & Kashmir*	1,128	6.1%	7.3%	8%	151%	125	182	47.8
Tripura	405	9.6%	8.5%	3%	133%	139	123	66.2
Meghalaya	267	8.2%	5.8%	4%	88%	111	121	34.6

Note: 1. (*) – As of FY 2019, (^) – As of FY 2020
2. Credit account penetration is calculated as total number of retail bank credit accounts/population of the state
3. Deposit account penetration is calculated as total number of bank deposit accounts/ population of the state
4. Branch penetration is calculated as Number of bank branches per million people
5. ATM penetration is calculated as Number of ATMs per million people
6. For Credit and Deposit account penetration, this does not represent unique borrowers or depositors, total number of accounts have been considered
7. Andhra Pradesh and Telangana have been considered as one state
Source: RBI, MOSPI, CRISIL Research

CRISIL Inclusix, an index that measures the extent of financial inclusion at a geographical level across all districts in India, reported a score of 58.0 at the end of Fiscal 2016, up from 50.1 in Fiscal 2013 and 35.4 in Fiscal 2009. The index scores each district in India on a scale of 0 to 100 with 0 being the worst and 100 being the best. The overall improvement of the score in Fiscal 2016 was mostly driven by JAM trinity: Jan Dhan Yojana, Aadhaar and mobile.

Kerala had the highest CRISIL Inclusix score as of 2016 with only 1 district having a score less than 70. Goa, Karnataka, Andhra Pradesh are other states with higher Inclusix scores and no districts having a score below 50. States such as Uttar Pradesh and Bihar, on the other hand, have an Inclusix score below 45, with a large majority of districts – 50% in case of Uttar Pradesh and 65% for Bihar – having Inclusix scores below 40. North-eastern states like Manipur, Nagaland and Meghalaya have the lowest Inclusix scores with hardly any district having a score more than 50.

State	CRISIL Inclusix Score (FY2016)	Number of districts with CRISIL Inclusix score in the stated range					
		More than 70	60-70	50-60	40-50	Less than 40	Total number of districts
Kerala	90.9	13	1	0	0	0	14
Goa	88.9	2	0	0	0	0	2
Puducherry	87.7	3	1	0	0	0	4
Chandigarh	86.7	1	0	0	0	0	1
Delhi	86.1	1	0	0	0	0	1
Karnataka	82.1	20	5	5	0	0	30
Andhra Pradesh	78.4	10	3	0	0	0	13
Tamil Nadu	77.2	22	8	2	0	0	32
Telangana	72.8	7	3	0	0	0	10
Himachal Pradesh	72.3	9	2	1	0	0	12
Punjab	70.9	9	10	1	2	0	22
Uttarakhand	69.0	3	7	3	0	0	13
Haryana	67.7	7	10	1	2	1	21
Tripura	66.2	2	1	0	5	0	8
Andaman & Nicobar	63.9	1	0	0	0	2	3
Odisha	63.0	6	7	8	7	2	30
Maharashtra	62.7	9	6	8	11	2	36
Gujarat	62.4	10	5	4	7	7	33
Daman and Diu	60.7	0	1	1	0	0	2
Dadra and Nagar Haveli	60.2	0	1	0	0	0	1
Sikkim	60.2	1	0	0	2	1	4
West Bengal	53.7	2	4	5	6	3	20
Lakshadweep	51.3	0	0	1	0	0	1
Rajasthan	50.9	2	3	10	10	8	33
Madhya Pradesh	48.7	3	3	12	15	18	51
Jharkhand	48.2	2	3	2	5	12	24
Assam	47.9	2	4	3	8	10	27
Jammu & Kashmir	47.8	1	2	3	7	9	22
Chhattisgarh	45.7	2	0	5	5	15	27

Uttar Pradesh	44.1	4	4	5	25	37	75
Mizoram	43.2	0	0	1	1	6	8
Bihar	38.5	1	0	0	12	25	38
Arunachal Pradesh	34.7	1	0	2	0	14	17
Meghalaya	34.6	0	0	1	0	10	11
Nagaland	32.4	0	1	0	2	8	11
Manipur	32.0	0	1	0	0	8	9
Total	58.0	156	96	84	132	198	666

Note: CRISIL Inclusix, India's first financial inclusion index, was launched in 2013 with the objective of creating a dependable yardstick that would become a policy input to further the cause of inclusion. CRISIL Inclusix weighs three service providers (banks, insurers and MFIs) on four dimensions (branch, credit, deposit and insurance).
Source: CRISIL Inclusix, CRISIL Research

Key steps taken by the government to boost financial inclusion

To improve financial inclusion, especially in rural areas, the Government is focusing on improving the overall and rural infrastructure for penetration of financial services as well as empowering the development of parallel supporting institutions. This has provided an opportunity for payment banks and other financial institutions to cater to the unserved population or act as a channel between the larger financial institutions and other service providers to better serve the underserved customers.

Considerable progress has been made over the past 5-7 years to bring unbanked individuals into the formal banking system. The RBI and the Government have taken several measures, such as:

Pradhan Mantri Jan Dhan Yojana

Pradhan Mantri Jan Dhan Yojana (PMJDY), launched in August 2014, is aimed at ensuring affordable access to financial services – banking/savings and deposit accounts, remittances, credit, insurance, and pension.

PMJDY focuses on household coverage as compared with the earlier schemes that focused on coverage of villages. It aims to extend banking facilities to all within a reasonable distance in each sub-service area (consisting of 1,000-1,500 households) across India.

As on March 31, 2021, 422 million PMJDY accounts had been opened, of which, 66% were in rural and semi-urban areas, with total deposits of Rs.1455 billion.

Although the opening of Jan Dhan accounts has increased financial inclusion, the high proportion of zero-balance or dormant accounts is a concern. However, the number of inoperative accounts under PMJDY is declining, as per the official website of the Government of India. The data shows that the percentage of inoperative accounts (of total Jan Dhan accounts) declined from 76.8% in September 2014 to less than 14% in August 2020.

While the Government's move to route subsidies through this channel is a major reason for decreasing zero-balance accounts, the increased availability of low-cost financial instruments is popularising formal financial institutions amongst the unbanked population. In fact, since the launch of the insurance and pension Jan Suraksha schemes in August 2015, the proportion of dormant accounts has fallen. (*Source: Global Findex Database, 2017*)

With various other schemes, such as Pradhan Mantri Social Security Schemes including Pradhan Mantri Jeevan Jyoti Bima Yojana, Atal Pension Yojana and Pradhan Mantri Suraksha Bima Yojana being run under PMJDY, people have ample reason to enrol for the PMJDY.

Pradhan mantri Suraksha Bima Yojana: PMSBY was launched on May 9, 2015. It offers a renewable one-year accidental death cum disability cover of Rs 200,000 to all subscribing bank account holders in the age group of 18 to 70 years for a premium of Rs.12 per annum per subscriber. As of 26 May, 2021, 234 million people were enrolled under the scheme and 45,992 claims had been disbursed out of 59,461 claims received.

Pradhan Mantri Jeevan Jyoti Bima Yojana: PMJJBY was launched on May 9, 2015. It offers a renewable one year term life cover of Rs.200,000 to all subscribing bank account holders in the age group of 18 to 50 years, covering death due' to any reason, for a premium of Rs.330/- per annum per subscriber. The scheme is offered / administered through Life Insurance Company (LIC) and other life insurance providers willing to offer the product on similar terms. As on 26 May, 2021, 103 million people have been enrolled under this scheme and 244,197 claims have been disbursed out of 260,547 claims received.

Atal Pension Yojana: The Atal Pension Yojana (APY) was launched on May 9, 2015 to create a universal social security system for all Indians, especially the poor, the under-privileged and the workers in the unorganised sector. APY is administered by Pension Fund Regulatory and Development Authority (PFRDA). APY is open to all bank account holders in the age group of 18 to 40 years and the contributions differ, based on pension amount chosen. Subscribers would receive the guaranteed minimum monthly pension of Rs. 1,000 or Rs. 2,000 or Rs. 3,000 or Rs. 4,000 or Rs. 5,000 at the age of 60 years. As of March 31, 2021, there were more than 22 million subscribers for this scheme.

Pradhan Mantri Mudra Yojana ("PMMY"): PMMY is a scheme launched by the Hon'ble Prime Minister on April 8, 2015 for providing loans up to Rs 1 million to the non-corporate, non-farm small/micro enterprises. These loans are classified as Micro Units Development and Refinance Agency (MUDRA) loans under PMMY. These loans are given by Commercial Banks, Regional Rural Banks (RRBs), Small Finance Banks, MFIs and NBFCs. As of 31 July 2021, 306.1 million MUDRA loans worth more than Rs.16 trillion have been sanctioned.

Standup India Scheme: The scheme was launched by the Hon'ble Prime Minister on April 5, 2016. The objective of the scheme is to facilitate bank loans between Rs.1 million and Rs. 10 million to at least one Scheduled Caste (SC) or Scheduled Tribe (ST) borrower and at least one woman borrower per bank branch for setting up a Greenfield enterprise. This enterprise may be in manufacturing, services, agri-allied activities or the trading sector. In case of non-individual enterprises at least 51% of the shareholding and controlling stake should be held by either an SC/ST or woman entrepreneur. As of March 31, 2021, 117,560 applications amounting to more than Rs.265 billion have been sanctioned under the scheme.

Payment banks

Another step taken towards financial inclusion was the RBI granting in-principle approval on August 19, 2015 to 11 players to launch payment banks. The decision came after the recommendations from Nachiket Mor Committee to set up a specialized bank ("Payments Bank") to cater to the low income groups. After the licences were granted to 11 players, three players withdrew their application. Of the remaining eight, seven institutions – India Post Payments Bank Ltd, Airtel Payments Bank Ltd, PayTM Payments Bank Ltd, Fino Payments Bank, Aditya Birla Idea Payments

Bank Ltd and Jio Payments Bank and NSDL Payments Bank had commenced operations. In 2019, Aditya Birla Payments Bank Ltd shut down its operations due to mounting losses.

The objective of a payments bank is to widen the spread of payment services and deposit products to small businesses, low-income households, migrant labour workers and other unorganized entities by enabling high volume low value transactions in deposits and payments/remittance services in a secured technology-driven environment.

Payment banks can accept deposits, subject to a cap of Rs. 200,000 per customer, and provide payment and remittance services through channels, such as the internet, branches, business correspondents (BCs) and mobile banking. (The deposit limit was enhanced to Rs.200, 000 from the earlier limit of Rs. 100,000 in April 2021.) However, these banks cannot offer credit facilities directly, but can choose to act as a BC of another bank for credit and other services.

Along with maintaining a cash reserve ratio (CRR) with the RBI, payment banks are required to invest a minimum of 75% of their demand deposit balance in Government securities eligible under the statutory liquidity ratio (SLR), with maturity of up to one year, and hold a maximum 25% in current and fixed deposits with Scheduled Commercial Banks (SCBs). As of March 31, 2020, the total deposits with payment banks stood at Rs 23 billion.

Small Finance Banks (SFBs)

As of July 2021, the RBI had awarded SFB licenses to 11 institutions, which aim to service the underserved customers through savings instruments, and supplying credit to small business units, small and marginal farmers, micro and small industries, and other unorganised sector/lending through informal channels. SFBs are also required to dedicate 75% of their Adjusted Net Bank Credit (ANBC) towards priority sector. For the SFBs, nearly 20% of their deposits arise from the rural and semi-urban areas, whereas the credit view shows that 40% of their advances are extended in rural and semi-urban areas as of March 31, 2021. This has led to increasing credit penetration in rural areas, thereby ensuring financial inclusion.

Microfinance Institutions

MFIs have significant role to play in furthering financial inclusion, by providing small ticket loans to customers, usually for productive purposes. As of March 31, 2021, Microfinance segment has a total loan amount outstanding of Rs. 2279 billion of which 41% was financed by Banks and 31% by NBFC-MFIs.

Business Correspondents (BCs)

In one of its foremost measures, the RBI introduced the BC model of banking outreach in January 2006, aimed at leveraging information and communication technology to widen access to the banking system. BCs are retail agents engaged by banks to offer banking services at locations other than a bank branch/ATM. They are authorised to perform a variety of activities including collection of small-value deposits, disbursal of small-value credit, recovery of principal, collection of interest, sale of micro insurance, mutual fund products, pension products, other third-party products, and receipt and delivery of small value remittances/other payment instruments. In July 2014, the RBI allowed NBFC-MFIs to work with banks as BCs. As of December 2020, 360 million basic savings bank deposit accounts (BSBDA) were opened through BCs (*Source: RBI*)

Aadhaar

Adoption of Aadhaar and Aadhaar authentication in the Indian financial system is expected to transform the financial landscape. To increase financial inclusion, the Unique Identification Authority of India partnered with the RBI, National Payments Corporation of India (NPCI), Indian Banks Association (IBA) and banks to develop:

- Aadhaar Payments Bridge (APB) – The system was launched in 2011 to enable a smooth transfer of all government welfare scheme payments to a beneficiary's Aadhaar Enabled Bank Account (AEBA)
- Aadhaar enabled payment system (AEPS) – A system that leverages Aadhaar online authentication and enables AEBAs to be operated in anytime-anywhere banking mode by the marginalised and financially excluded via micro ATMs

According to the Ministry of Electronics and IT, Aadhaar-generated unique identity covered over 99% of total estimated adult population of India, as of December 2020. An Aadhaar number will be used to verify the identity of a person receiving a subsidy or a service. Disbursements will take place through a centralised electronic benefit transfer system using the unique Aadhaar beneficiary numbers.

The Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Bill, 2016, came into effect on March 25, 2016, to strengthen the role of the Aadhaar card. The Bill aims at providing targeted delivery of subsidies and services to individuals residing in India by assigning them a unique Aadhaar numbers. To reduce the cost of consumer on-boarding and transactions, the government launched IndiaStack. IndiaStack is a set of APIs that allows government businesses, start-ups and developers to utilise a unique digital infrastructure to solve problems, such as presence less, paperless and cashless services delivery.

Also, Aadhaar-enabled micropayments have many features, including elimination of the need for individual KYC requirements by banks for no-frills or basic accounts, and reductions in the direct and indirect KYC cost of financial institutions on account of the UIDAI's 'know your residence' standards being sufficient for authentication.

Aadhaar-enabled payments with clear authentication and verification process allow financial institutions to network with village-based BCs. Thus, customers will be able to withdraw money and make deposits at the local BC. UIDAI's authentication will help banks verify residents both in person and remotely. The electronic transfer, backed by UIDAI's authentication, will help residents transact electronically, reducing the cost of transactions. Also, it has helped reduce the KYC approval turnaround time from the previous 10-15 days, when the customer had to submit various documents for identity and address proof, to almost-instant KYC approval.

As per the Supreme Court's Judgment of September 2018, the Aadhaar Act was held constitutional, however, it was also held that Aadhaar cannot be made mandatory for availing banking services and body corporates/persons were restrained from using Aadhaar details pursuant to a contract only. It further held that the use of the Aadhaar must be backed by a legislation. Accordingly, the amendment in the legislation was brought about in February 2019, whereby banks were allowed to use Aadhaar for KYC but with customer consent. This enabled banks to open instant bank accounts using eKYC based on Aadhaar authentication through the OTP mode. The change in the RBI's KYC guidelines is in line with the changes made by the government to the Prevention of Money-laundering Rules (PMLA) in February 2019 and the Aadhaar and Other Laws (Amendment) Ordinance, 2019 (passed in Lok Sabha in July 2019). The Department of Revenue, vide its circular issued in May 2019, had also notified that all regulated entities may approach their respective regulators to seek Aadhaar authentication facilities. However, fintech companies are still not allowed to use biometrics or OTP-based eKYC and are only permitted to use offline Aadhaar verification. Furthermore, maximum lending through OTP-based e-KYC is Rs 60,000.

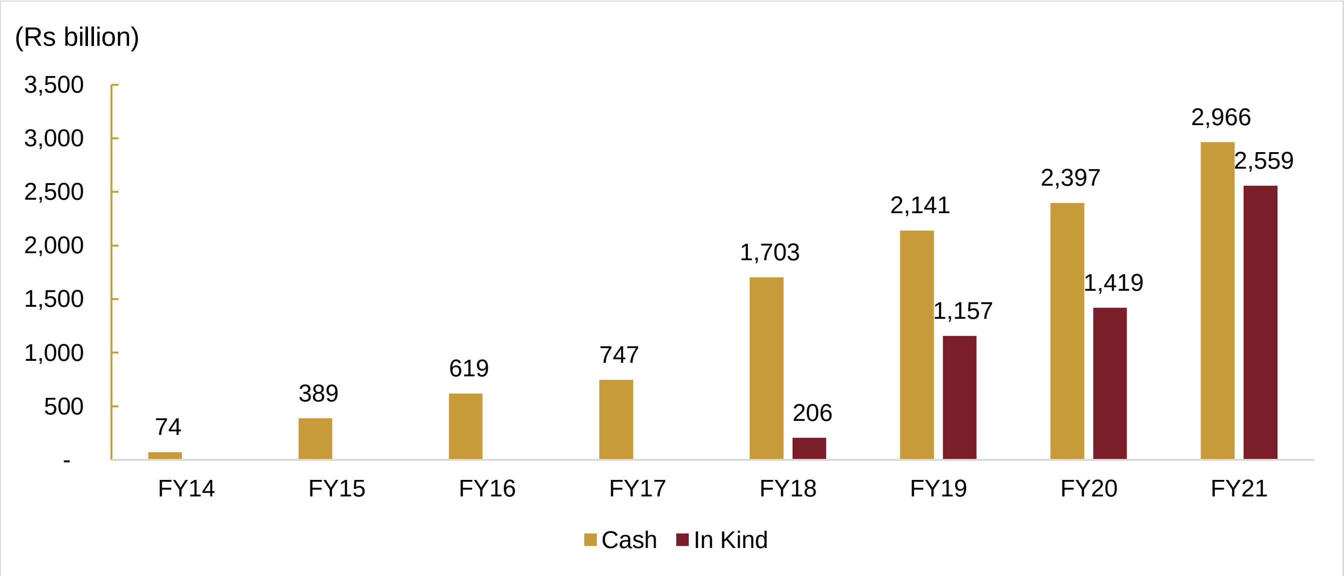
Digital India

An umbrella programme to transform India into a knowledge economy has supported the financial inclusion initiative. Some of the initiatives under this programme include development of digital infrastructure, delivery of government services digitally and improvement in digital literacy, especially in rural India.

Some of the initiatives include:

- **Direct-benefit transfer:** As of end of fiscal 2014, only 28 schemes were covered under the direct-benefit transfer (DBT), where the payment is directly done into the bank account of the beneficiary. This has grown to 318 schemes as of the end of fiscal 2021. Benefit transfer in form of cash through the DBT mechanism has increased from approximately Rs. 2,141 billion in fiscal 2019 to Rs. 2,397 billion in fiscal 2020 to Rs 2,966 billion in fiscal 2021. This has resulted in fewer slippages, and faster and easier remittance to the intended. This, in turn, is expected to give rise to the usability of agent network for other related transactions, when the money is already in the bank accounts of customers. CRISIL Research expects the availability of funds in the bank accounts of the beneficiaries will support growth in digital transactions.

Amount transferred to beneficiaries through DBT



Note: DBT also includes in-kind transfers which includes transfer of goods and services at very low price or for free to the beneficiaries of various such Government schemes

Source: DBT website; CRISIL Research

- **Common service centres 2.0:** This is a service delivery-oriented entrepreneurship model, with a large variety of services made available for citizens. Under Digital India, at least one common service centre (CSC) was envisaged for each of the 250,000 gram panchayats, including the 100,000 operational CSCs launched in the initial version of the programme. The objectives of the programme include:

– Non-discriminatory access to e-services for rural citizens

– Expanding the self-sustaining CSC network to the gram panchayat level

– Empowering District e-Governance Societies (DeGSs) under the district administration for implementation

- Creating and strengthening the institutional framework for rollout and project management, thereby supporting the state and district administrative machinery
- Enabling and consolidating online services under a single technology platform
- Providing a centralised technological platform for delivery of services, transparently to citizens
- Increasing the sustainability of village-level entrepreneurs (VLEs) by sharing maximum commission earned through delivery of e-services and encouraging women to join as VLEs

The services to be provided at the CSCs include agriculture services, education and training services, rural banking and insurance services, entertainment services, utility services, healthcare services, and other commercial services.

- **BharatNet:** This project aims to provide 100 Mbps broadband connectivity to almost all the 0.25 million gram panchayats in the country. Under the first phase of the project, 100,000 gram panchayats were to be connected by laying underground optical fibre cable (OFC). Under Phase-II, targeted to be completed by March 2019, connectivity will be provided to the remaining 0.15 million gram panchayats, using an optimal mix of underground fibre, fibre over power lines, radio and satellite media. As per Bharat Broadband Network Limited (BBNL), ~0.14 million gram panchayats have been linked with this.

Moreover, under the 'Digital India program', the government also proposed to provide free-high speed Wi-Fi in 2,500 cities and towns, at an estimated investment of Rs 70 billion. Under the plan, the government aims to set up 50,000-60,000 Wi-Fi hotspots across the country.

CRISIL Research expects, on completion, these projects will help catalyse the growth of digital services to the rural masses, and especially to the lower category of the population. This strengthening of digital infrastructure will help various sectors including healthcare, education, skills training, etc. It would provide the private enterprises with an opportunity to expand their services in these remote underserved areas.

Priority sector lending aimed at facilitating financial inclusion

The definition of 'priority sector' was formalised in 1972, based on a report submitted by the Informal Study Group on Statistics, relating to advances to priority sectors, constituted by the RBI in May 1971. The requirement for PSL as a proportion of Adjusted NBC was set at 33.3% for SCBs in 1979, and raised to the current 40% in 1985. Currently, all banks including foreign banks need to comply with this 40% requirement.

Targets and sub-targets for banks were further classified under the priority sector and revised at intervals. As per the latest regulations, unveiled in 2015, medium enterprises, social infrastructure and renewable energy are part of the priority sector, in addition to the existing categories. Also, non-achievement of priority sector targets has been assessed on a quarterly average basis at the end of the respective year, from fiscal 2017 onwards, instead of annually.

As per the RBI, these sub-divisions include:

- **Agriculture:** For all SCBs, 18% of the ANBC or the credit equivalent amount of off-balance sheet exposure (CEOBE), whichever is higher, is to be extended for agriculture. Within the 18% target for agriculture, a target of 10% of ANBC or CEOBE, whichever is higher, has been prescribed for small and marginal farmers.

Also, the sub-target of 10% of ANBC or the CEOBE, whichever is higher, is applicable for foreign banks with 20 branches or more, for lending to small and marginal farmers.

- **Social infrastructure:** A maximum bank loan of Rs 50 million will be extended per borrower to build social infrastructure, including schools, healthcare, drinking water, and sanitation facilities, as well as construction/ refurbishment of household toilets and household-level water improvements in tier II to VI centres. Bank credit to MFIs, extended for on-lending to individuals and to members of self-help groups (SHGs)/ joint lending groups for water and sanitation facilities, will be eligible for categorisation as the priority sector under 'social infrastructure'.

- **Renewable energy**: Bank loans up to Rs 150 million will be given to borrowers for solar-based power generators, biomass-based power generators, wind mills, micro-hydel plants, and for non-conventional energy-based public utilities (street lighting systems), and remote village electrification. For individual households, the loan limit is Rs 1 million per borrower.

- **Microcredit:** As much as 7.5% of ANBC or the CEOBE for all SCBs should be given in the form of microcredit. Further, the sub-target of 7.5% of ANBC or CEOBE, whichever is higher, for banks' lending to microenterprises will also be applicable to foreign banks with 20 branches and above from fiscal 2019.

- The RBI has also removed the currently applicable loan limits of Rs 50 million and Rs 100 million per borrower to micro/small and medium enterprises (services), respectively, for classification under the priority sector. Accordingly, all bank loans to MSMEs, engaged in the provision or rendering of services as defined in terms of investment in equipment under the MSMED Act, 2006, will qualify under the priority sector without any credit cap.

- **Advances to weaker sections:** 12% of ANBC or the CEOBE, whichever is higher, must to be extended to weaker sections. Foreign banks with 20 branches or more had to achieve the weaker sections target within five years, between April 1, 2013 and March 31, 2018, as per the action plan submitted by them and approved by the RBI.

- **Education loans:** These include loans and advances granted to individuals only for educational purposes, including vocational courses, of up to Rs 1 million. These loans and advances will be considered eligible for the priority sector.

- **Housing:** The government has tried to bring greater convergence of PSL guidelines for housing loans with the Affordable Housing Scheme and boost low-cost housing for economically weaker sections and lower income groups. Thus, it decided to revise the housing loan limits for PSL eligibility from the existing Rs 2.8 million to Rs 3.5 million in metropolitan centres (with a population of 1 million and above), and from the existing Rs 2 million to Rs 2.5 million in other centres, provided the overall cost of the dwelling unit in the metropolitan centre and at other centres does not exceed Rs 4.5 million and Rs 3 million, respectively.

For foreign banks with less than 20 branches, no specific sub-targets for sectors are laid out. For these banks, up to 32% can be in the form of lending to exports and not less than 8% can be to any other priority sector.

In September 2020, RBI new guidelines for PSL, wherein higher weights would be assigned to districts having a relatively lower credit penetration. From FY22, a weight of 125% would be assigned to incremental priority sector credit in identified districts where credit flow is lower and per capita PSL is lower than Rs 6,000. A lower weight of 90% will be assigned to incremental PSL in identified districts where credit flow is relatively higher and per capita PSL is more than Rs 25,000. Other districts will continue to have the existing weightage of 100%. This will incentivise credit flow to credit deficient geographies.

Business opportunities available owing to financial inclusion on the asset and liability side

Factors such as lack of documents, migration of individuals for work or other purposes, lack of transaction history with financial institutions, etc., have led to low inclusion of households in the financial system. Also, the costs involved in setting up a network to serve the traditionally ignored categories, such as migrants, rural population, retailers, shop owners, and MSMEs, is high.

In addition, the gap between various regions of the country, as highlighted above, is very wide. However, owing to the Government's emphasis and growth of the banking facility in these regions, the gap is slowly getting plugged. This gives financial institutions an opportunity to expand their services in underserved regions.

Key business opportunities among various population categories - assets and liabilites

Migrants - ~100 million migrant workforce

- Remittance services
- Account services
- Deposit services

Retailers - ~24-25 million retail outlets

- Payments
- Loans
- Digitalisation of business functions

MSME - ~70 million businesses

- MSME loans
- Working capital finance
- Fee-based services

Rural population - ~ 66% of India's population

- Basic banking services
- Personal loans
- Bill payments and bookings
- Investment in mutual funds and insurance products
- Education loans
- Gold loans

Source: CRISIL Research

MSME sector in India

Brief overview of MSMEs in India

The National Sample Survey (NSS) 73rd round dated June 2016 estimated that there are around 63.5 million MSMEs in India. Since then, the number of MSMEs is estimated to have increased further to around 70 million as of fiscal 2021. MSMEs complement large corporates as suppliers or directly cater to end users. The MSME sector contributes to the country's socio-economic development by providing huge employment opportunities in rural and backward areas, reducing regional imbalances, and assuring equitable distribution of national wealth and income. The segment currently contributes to 30% of the GDP, over 40% of exports and creates employment for about 110 million people in the country, thus supporting economic development and growth.

MSME segment account for 30% of India's GDP

Rs trillion	Total MSME GVA	Growth (%)	Total GVA	Share of MSME in GVA (%)	All India GDP	Share of MSME in All India GDP (in %)	Number of MSMEs (in millions)*
FY16	41	11.0%	126	32.3%	138	29.5%	63.5
FY17	45	10.9%	140	32.2%	154	29.3%	65.5
FY18	51	13.0%	155	32.8%	171	29.7%	66.5
FY19	57	12.9%	171	33.5%	190	30.3%	68.5

Note: (*) - Estimated

Source: MSME Ministry Annual report for FY21, CRISIL Research

The RBI has adopted the definition of MSMEs in line with the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006. This definition is based on investments in plant and machinery in the manufacturing and services sectors.

To bring in more enterprises under the ambit of MSMEs and widen the definition of MSMEs taking into account inflation over the past few years, in June 2020, the Government revised the MSME investment limit across each category and introduced an alternate and additional criteria of turnover buckets to the definition. It further removed the difference between the definition of manufacturing based and services based MSMEs.

In June 2021, the government has included retailers and wholesalers under the MSMEs definition to extend the benefits of priority sector lending to traders as well. The move is structurally positive from long-term perspective, as it will enable entities operating in the segment to register on Government's UDYAM portal, participate in government tenders and also avail financing options/benefits available to the category.

Given below is the composite new, revised definition of MSMEs in comparison to the old existing one:

New MSME definition removed distinction between manufacturing and services

Old MSME classification			
Criteria : Investment in plant and machinery or equipment			
Classification	**Micro**	**Small**	**Medium**
Manufacturing enterprises	Investment < Rs. 2.5 million	Investment < Rs. 50 million	Investment < Rs. 100 million
Services enterprises	Investment < Rs. 1 million	Investment < Rs. 20 million	Investment < Rs. 50 million
Revised MSME classification			
Composite Criteria : Investment and annual turnover			
Classification	**Micro**	**Small**	**Medium**
Manufacturing and Services enterprises	Investment < Rs. 10 million and Turnover < Rs. 50 million	Investment < Rs. 100 million and Turnover < Rs. 500 million	Investment < Rs. 500 million and Turnover < Rs. 2.5 billion

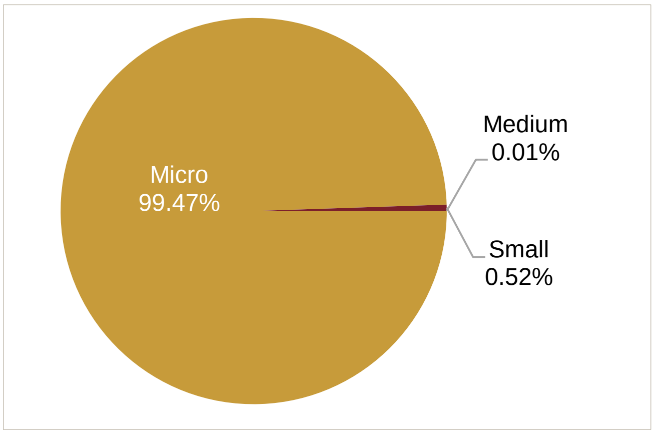
Source: MSME Ministry, CRISIL Research

Financial institutions also use internal business classifications to define MSMEs, based on their turnover. Most banks and non-banks follow this practice.

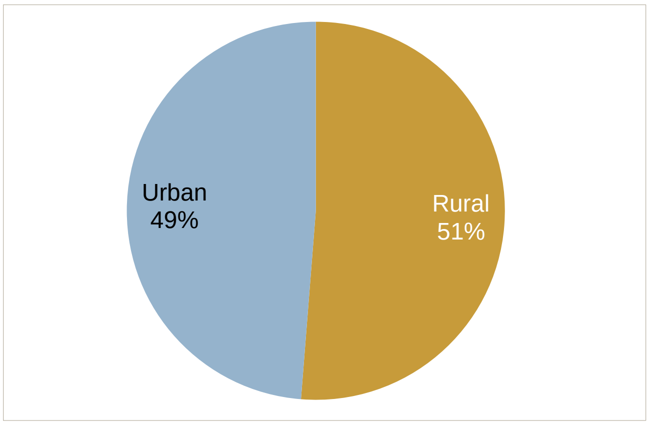
Micro segment accounted for as much as ~ 99.47% of total estimated number of MSMEs in India. Small and medium sector accounted for 0.52% and 0.01%, respectively of the total estimated MSMEs. At a region level, rural regions accounted for marginally higher share of 51% as compared to urban region. MSMEs units are largely dominated by bigger states including Uttar Pradesh, West Bengal, Tamil Nadu, Maharashtra and Karnataka. The top 5 states together accounted for ~50% of the total number of MSMES in India. Service sector accounts for dominant 79% share in MSMEs, of which retail forms major share.

In terms of constitution, close to 94% of the entities in the MSME universe in India are estimated to be sole proprietorship firms, wherein a small business undertaking is run and managed by the business owner and the business and the owner can virtually not be separated.

Micro segment accounts for dominant share

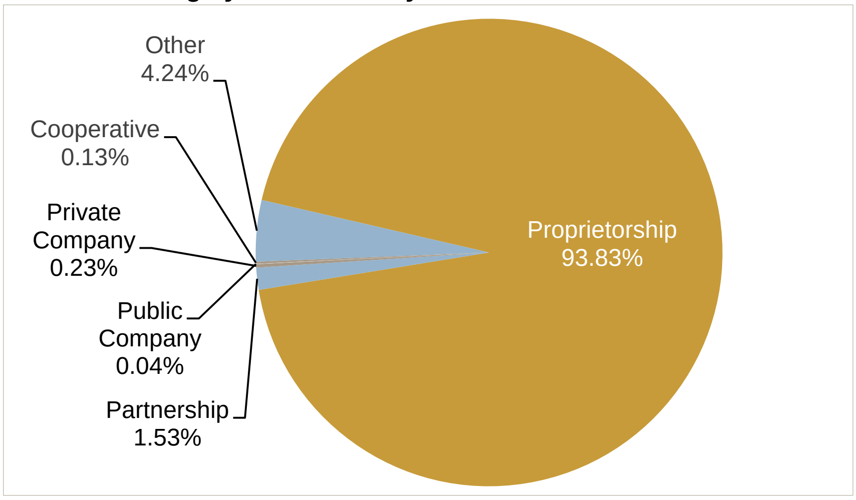


Rural region accounts for marginally higher share



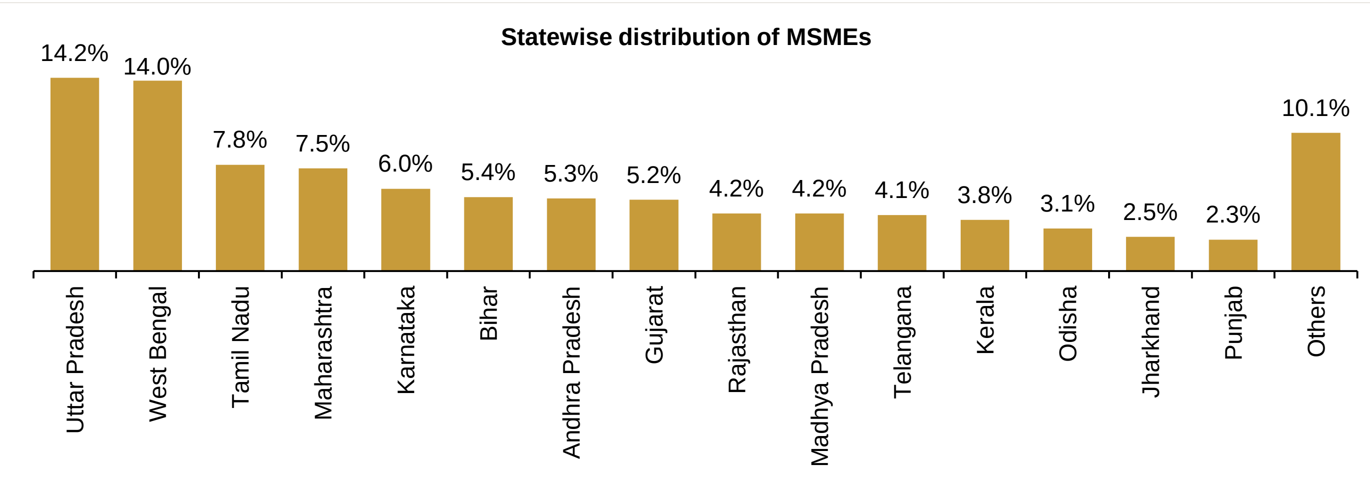
Source: National Sample Survey (NSS) 73rd round dated June 2016, CRISIL Research

MSMEs are largely dominated by individuals



Source: IFC, CRISIL Research

Top 5 states together form ~50% of total MSME units



Source: National Sample Survey (NSS) 73rd round dated June 2016, CRISIL Research

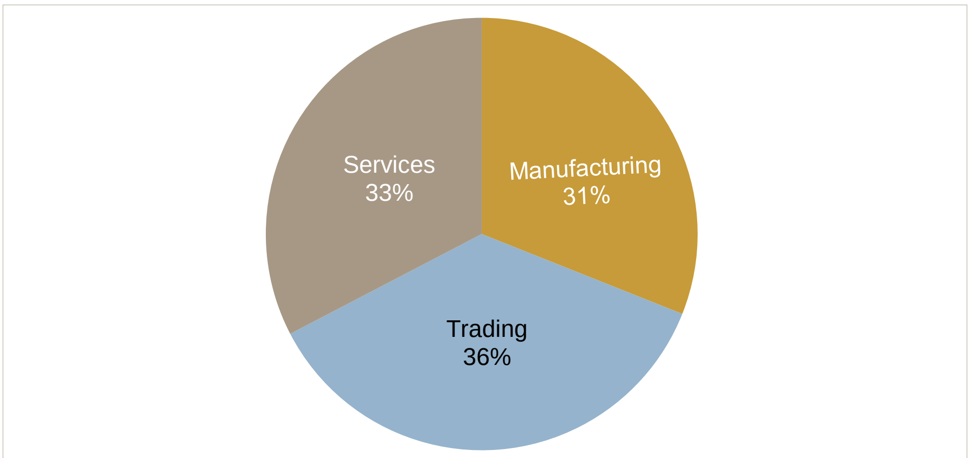
State-wise number of Micro, Small and Medium enterprises in India

States	Micro	Small	Medium	Total MSME
Uttar Pradesh	89,63,623	35,531	332	89,99,487
West Bengal	88,40,924	25,983	528	88,67,435
Tamil Nadu	49,26,652	20,812	157	49,47,621
Maharashtra	47,59,959	17,144	469	47,77,572
Karnataka	38,24,909	9,049	42	38,34,000
Bihar	34,41,300	4,259	2	34,45,561
Andhra Pradesh	33,74,136	12,556	290	33,86,983
Gujarat	32,66,544	49,744	113	33,16,400
Rajasthan	26,65,918	20,169	579	26,86,665
Madhya Pradesh	26,42,023	30,984	925	26,73,932
Telangana	25,93,968	10,048	555	26,04,571

States	Micro	Small	Medium	Total MSME
Kerala	23,58,300	20,716	378	23,79,395
Odisha	19,79,769	4,311	348	19,84,428
Jharkhand	15,77,873	9,946	51	15,87,870
Punjab	14,56,274	8,681	58	14,65,012
Others	63,79,356	50,933	453	64,30,740
All India	**6,30,51,524**	**3,30,866**	**5,282**	**6,33,87,673**

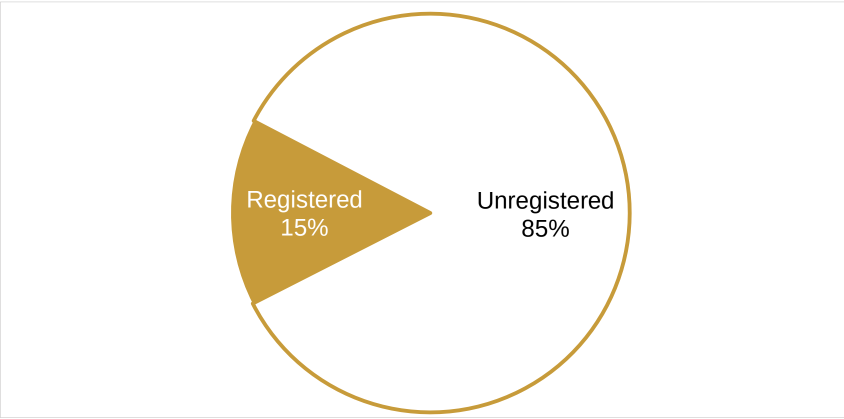
Source: National Sample Survey (NSS) 73rd round dated June 2016, CRISIL Research

Trading sector accounts for higher share in number of MSMEs



Source: MSME Ministry, CRISIL Research

Only 15% of MSMEs are registered (FY17)



Registered MSMEs includes entities that file business information with District Industry Centers (DCs) of the State / Union Territory

Source: IFC, CRISIL Research

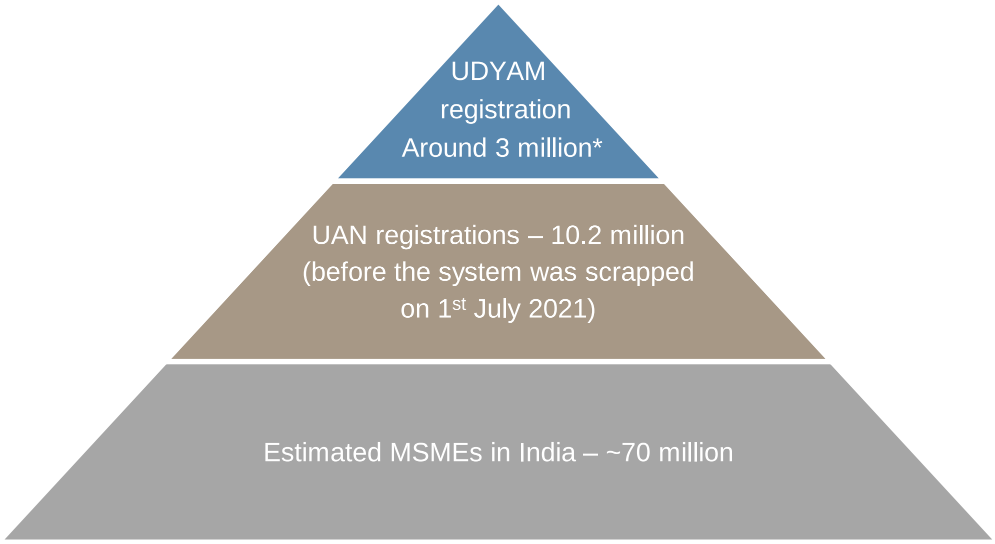
Small fraction of MSMEs in India registered under UDYAM system

After the government revised the definition of MSMEs (in June 2020), MSMEs that had the then existing MSME registration (Udyog Aadhaar Number or UAN) or Enterprise Memorandum (EM) were required to re-register themselves under UDYAM. Thereafter, in August 2020, the RBI issued a notification allowing financiers to obtain the UDYAM certificate from entrepreneurs for lending purposes.

As of August 24, 2021, close to 4.5 million MSMEs have registered on UDYAM. A much higher number of MSMEs – around 10.2 million – were registered on the erstwhile UAN system. This number pales in comparison to the total number of MSMEs in India, estimated at 65-70 million

Like UAN, UDYYAM also offers free, paperless online and instant registration through a web portal. Small businesses aren't required to upload any documents or proof except the Aadhaar number for registration. Earlier GST registration was mandatory for UDYAM Registration but from March 2021 onwards, it is exempted for those units who are not eligible for GST registration.

UDYAM certificate will be required by MSMEs for taking benefit of any scheme of the Central government. The UDYAM portal is also integrated with the Government e-Marketplace (GeM) and the Trade Receivables and Discounting System (TReDS) so that enterprises can participate in government procurement, and have a mechanism for discounting their bills.



**As of mid-May 2021*

Source: MSME Ministry, CRISIL Research

Probable reasons for low registration rates

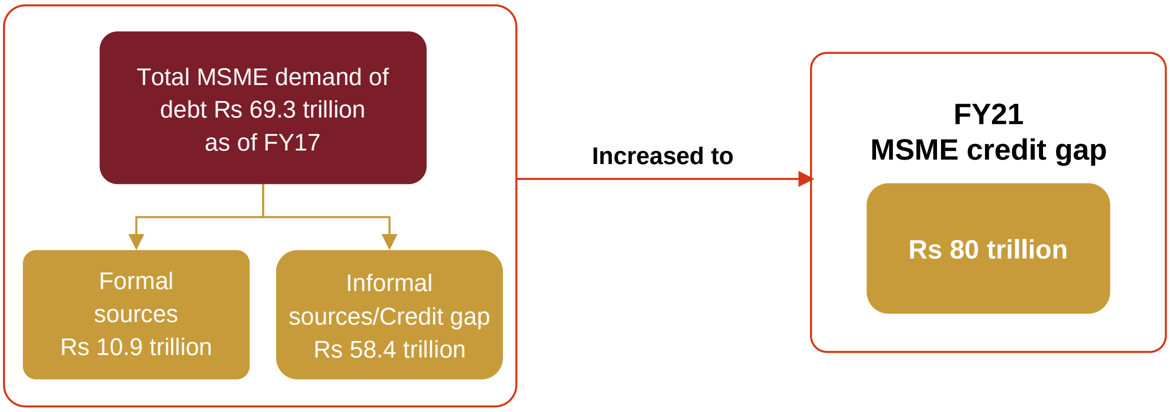
- Earlier, the requirement was that companies that wanted to register under UDYAM had to provide their GSTIN. Since many entities have a turnover of less than Rs 40 lakh and hence do not need to be GST compliant, they were ineligible to register on the UDYAM system. This requirement was removed by the MSME Ministry in early March 2021.
- Low levels of awareness regarding the roll-out of schemes, their eligibility conditions, paperwork requirements and grievance redressal mechanisms could have also impacted the registration of MSMEs. As per the NCAER Business Expectations Survey (BES) in December 2020, 75% of MSMEs were not even aware of Emergency Credit Line Guarantee Scheme (ECLGS) launched by the Government post-Covid.

MSME Credit gap estimated at Rs 80 trillion; Covid-19 has further widened the credit gap

High risk perception and prohibitive cost of delivering services physically have constrained formal lending to MSMEs. An IFC report titled Financing India's MSMEs (November 2018) estimated the MSME credit demand at Rs 69.3 trillion in fiscal 2017, of which only ~16% of demand met through formal financing[1] and consequently, the MSME credit gap *(defined as the gap between the demand for funds amongst MSMEs and the supply from formal financiers)* was estimated at Rs 58.4 trillion. This gap was met through informal sources including moneylenders, chit funds and personal sources from friends and relatives. The interest rate for these sources generally ranges between 30-60% per annum.

The credit gap is estimated to have further widened over the last 4 years due to slower economic growth in fiscal 2020, followed by the Covid-19 pandemic in fiscal 2021. Furthermore, government schemes post the Covid-19 pandemic such as the ECLGS scheme provided relief to MSME units with existing loans from a formal financial institution. As of fiscal 2021, the MSME credit demand is estimated to be around Rs 99 trillion, of which 19% of demand met through formal financing. Assuming an increase of around 8% annually[2] in the demand for credit and the availability of credit from formal sources, CRISIL Research estimates the credit gap to have further increased to Rs 80 trillion as of fiscal 2021.

MSME credit demand was largely met by informal sources



Source: IFC report on Financing India's MSMEs dated November 2018, CRISIL Research

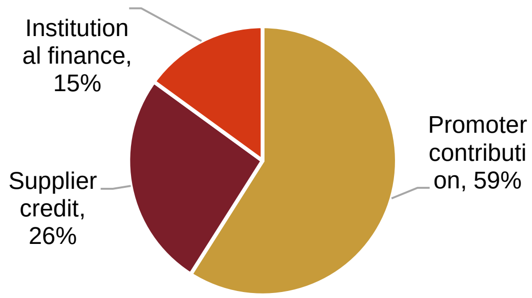
Smaller enterprises relatively more starved of credit

While the overall MSME credit gap is estimated at Rs 80 trillion, analysis of both SME gradings assigned by CRISIL between January 2010 to September 2015 and the Fourth Census of the MSME sector (2009) suggests that smaller enterprises are much more starved of institutional credit, and therefore, they primarily depend on promoter contribution for working capital and fund requirements. While the access to funding has improved in the last few years, credit remains out of bounds for large swathes of the MSME population in India.

Dependence on various sources of finance for working capital needs for enterprises with turnover below Rs 10 million	**Smaller enterprises much more starved of access to institutional finance**

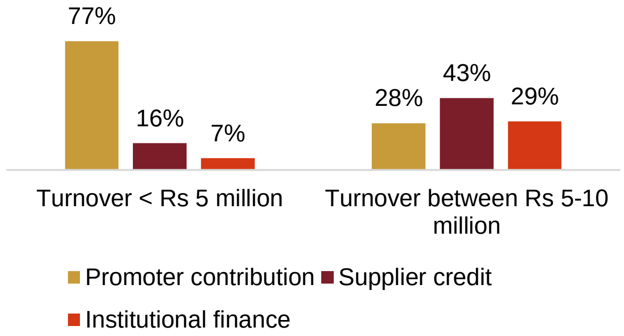
[1] *Formal sources includes Public sector banks, Private sector banks, Foreign banks, Regional rural banks (RRBs), Urban Cooperative Banks (UCBs), NBFCs, and government institutions including SIDBI and State Finance Corporations (SFCs).*

[2] *Based on MSME credit growth over fiscal 2017-21*



Note: Based on an analysis of 12,000 SMEs graded by CRISIL between January 2010 and September 2015

Source: CRISIL Ratings



Note: Based on an analysis of 12,000 SMEs graded by CRISIL between January 2010 and September 2015

Source: CRISIL Ratings

Sources of finance for SMEs with credit requirements of Rs 1 lakh to Rs 25 lakh

Source	Proportion of finance
Finance from institutional sources	5.2%
Finance from non-institutional sources	2.0%
No access to credit or self-financing	92.8%

Source: Fourth Census of the MSME sector (September 2009)

Even while the credit gap has increased, new MSME units continue to be set up across the country. During fiscal 2016 to 2020, 8.3 million units were set up, according to the government registration data of MSMEs. Thus, though a myriad of small businesses are set up every day in the country, access to credit remains a challenge.

Year-wise and MSME category-wise registration of MSMEs

Year/Category	FY16	FY17	FY18	FY19	FY20	Cumulative total for last 5 years
Micro	4,21,516	21,47,908	13,44,612	18,70,932	16,32,644	74,17,612
Small	70,866	2,16,558	1,66,259	2,41,187	2,22,226	9,17,096
Medium	2,631	8,592	6,584	9,426	8,506	35,739
Total	**4,95,013**	**23,73,058**	**15,17,455**	**21,21,545**	**18,63,376**	**83,70,447**

Source: Development Commissioner Ministry of Micro, Small & Medium Enterprises (DCMSME), CRISIL Research

Potential market for residential property-backed small business lending is estimated at Rs 22 trillion

The sheer size of the gap between the supply and demand of credit and the number of enterprises impacted indicates a veritable opportunity in MSME financing. There therefore exists a plethora of players – universal banks, small finance banks, traditional NBFCs, new age fintechs, MFIs, as well as local moneylenders – who try to meet the financing requirements of MSMEs by offering secured or unsecured loans straddling various tenures.

CRISIL Research has attempted to decipher the size of the potential opportunity in secured residential property-backed small business lending (hereafter referred to as the Addressable market for secured small business loans), using data, information and insights at a state-level pertaining to:

- Number of households from NSS 76th round (July 2018-December 2018)
- Self-employed non-agricultural households in both urban and rural areas from Periodic Labour Force Survey (PLFS) dated July 2019-June 2020
- Proportion of self-employed households, which are staying in their own pucca or semi-pucca home (which can be taken as a collateral by financiers) from NSS 76th round (July 2018-December 2018)

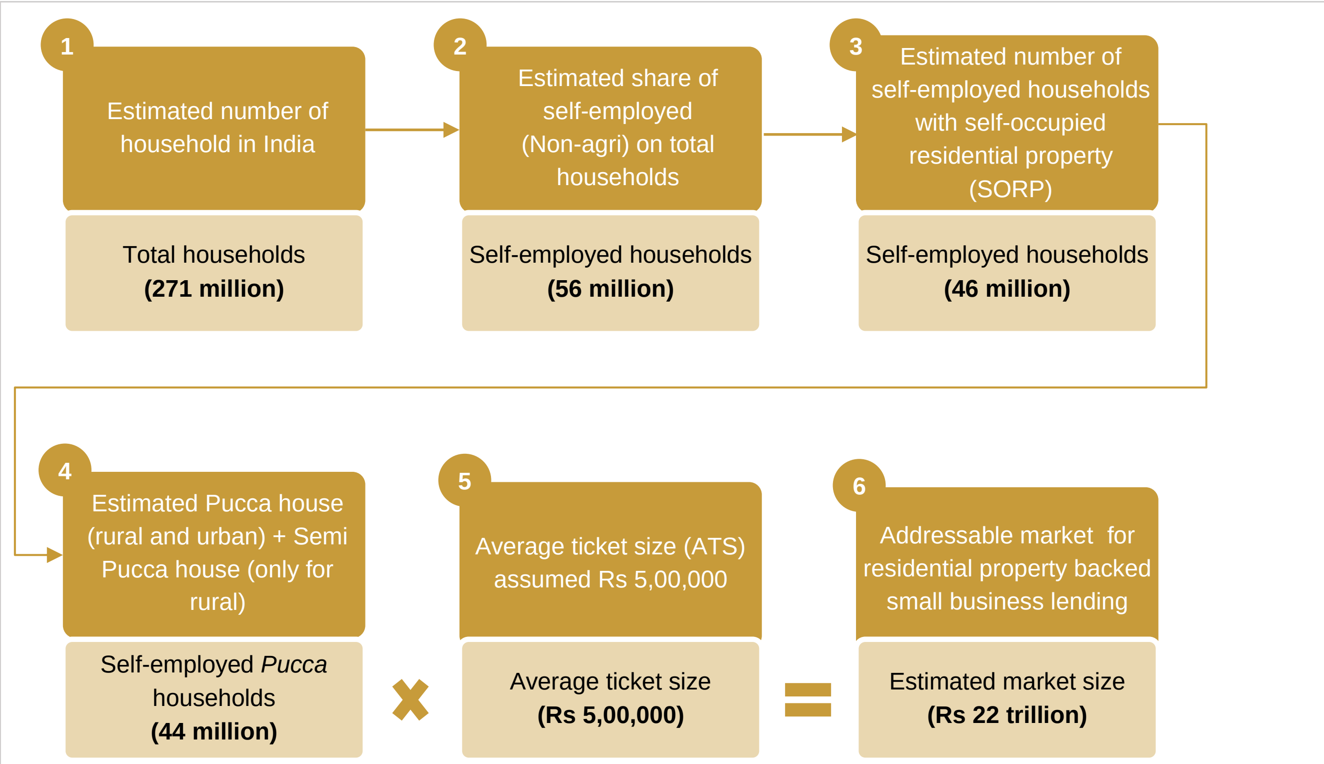
Based on our analysis and assumptions detailed in the chart below, small ticket size secured (SORP – Self occupied residential property) small business loan market potential is estimated at Rs 22 trillion. Players such as Five Star Business Finance, Vistaar Financial, Veritas Finance and AU SFB currently operate in this market; our analysis indicates the Addressable Market available for these players. The top 5 states including UP, West Bengal, Bihar, Maharashtra and Tamil Nadu together account for almost half the addressable market.

While the latent market opportunity is indeed significant, we observe that there are not many formal financiers who cater to this segment and have built scale. This can be attributed to the high cost of serving the market and the time it takes to build expertise, the requirement of having a strong knowledge of the local market and regional dynamics, and the challenges associated with building a credit underwriting model for non-income proof customers and collections infrastructure.

Most small businesses in India do not maintain documents such as income proof, business registration, GST registration, income tax filings, and bank statements, making credit assessment challenging. To illustrate, as per GST council data, only 12.9 million enterprises across various size dimensions were registered under GST as of June 2021. Hence, these businesses have limited or no access to formal credit from banks and financial institutions due to the requisite documentation and stringent underwriting norms.

Examples of such businesses include provision stores, building materials stores, tea shops, vegetable vendors and others. The small business in manufacturing and services include small fabrication units, machine tools manufacturers (using lathe machines), tailors, saloons, Gym owners, vehicle service centres, etc.

Addressable market estimation methodology for small business loans given to non-agriculture self-employed households with residential self-occupied property as collateral (FY21)



Source: National Sample Survey (NSS) 73rd round (July 2015 – June 2016) and NSS 76th round (July 2018 – December 2018), CRISIL Research

State wise split of addressable market

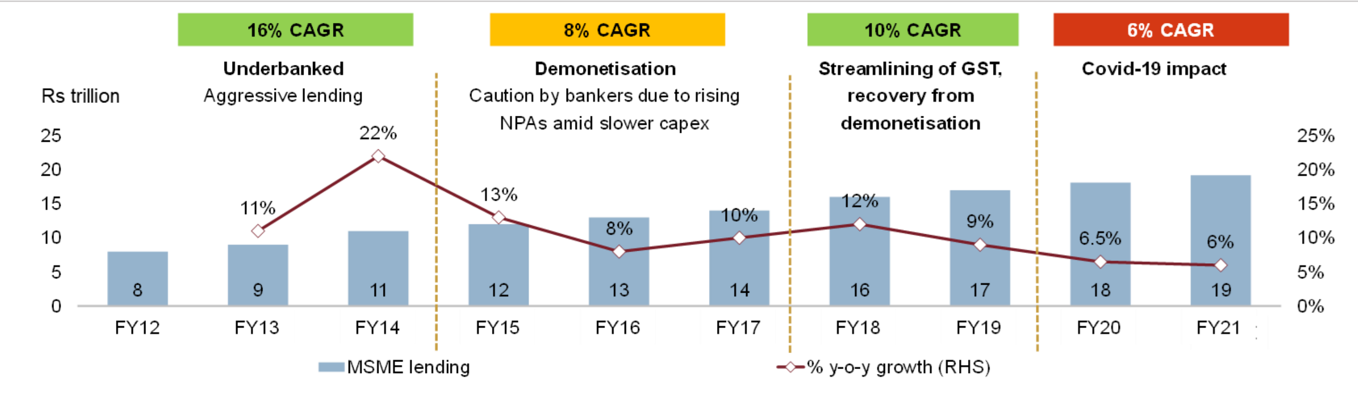
Top 15 states	Total Households ('000)	Total Non-agri Self Employed Households ('000)	Total Non-agri Self Employed Households - SORP ('000)	Total Non-agri Self Employed Households - SORP - Pucca + Semi Pucca ('000)	Addressable Market Size (Rs billion)
Uttar Pradesh	38,224	7,776	7,023	6,674	3,337
West Bengal	23,781	5,923	5,143	4,849	2,424
Bihar	19,960	4,498	4,270	3,953	1,976
Maharashtra	24,120	4,353	3,316	3,270	1,635
Rajasthan	13,384	3,075	2,743	2,685	1,342
Tamil Nadu	20,200	3,715	2,584	2,523	1,262
Gujarat	13,064	3,188	2,471	2,428	1,214
Madhya Pradesh	15,251	2,360	1,988	1,922	961
Andhra Pradesh	14,279	2,677	1,956	1,895	947
Kerala	8,577	1,988	1,795	1,789	895
Karnataka	14,928	2,740	1,822	1,786	893
Assam	6,740	1,965	1,702	1,660	830
Odisha	10,401	1,909	1,647	1,415	707
Punjab	5,922	1,636	1,415	1,409	705
Telangana	9,793	1,788	1,205	1,188	594
Others	32,483	6,585	5,317	5,180	2,590
All India	**2,71,105**	**56,115**	**46,397**	**44,624**	**22,312**

Source: National Sample Survey (NSS) 73rd round (July 2015 – June 2016) and NSS 76th round (July 2018 – December 2018), Periodic Labour Force Survey (PLFS) dated July 2019-June 2020, CRISIL Research

Overall MSME lending has grown at a CAGR of 10% in past decade; NBFC share estimated at 20%

CRISIL Research estimates the total size of MSME lending market across ticket sizes and various player groups (banks, NBFCs, small finance banks, and other formal lenders) to be around Rs 19 trillion as of March 2021. This market size includes loans taken by MSMEs across various constitution types (sole proprietorships, partnership firms, private and public limited companies, and co-operatives) and the ticket size spectrum, and includes loans extended in the name of the firm/entity/company as well as the individual in case of micro enterprises or entrepreneurs. We estimate loans to MSMEs to have grown at a CAGR of 10% during fiscal 2012 to fiscal 2021, which is more or less than the nominal GDP growth in this period. This can be attributed to various events during this time span that has hurt MSMEs – demonetisation of high-value currency loans in November 2016, the implementation of GST subsequently, the economic slowdown in fiscal 2020 followed by the Covid-19 pandemic.

MSME credit outstanding estimated at Rs 19 trillion as of March 2021; NBFCs enjoy 20% market share



Source: CRISIL Research estimates

NBFCs have managed to carve out a strong presence in MSME loans due to their focus on serving the needs of the customer segment, faster turnaround time, customer service provided and expansion in geographic reach. Over the years, the MSME portfolio of NBFCs have grown at a faster rate than the overall MSME portfolio at a systemic level. Thus, the share of NBFCs in total credit to MSMEs is estimated to have increased to ~20% at end of fiscal 2021 from 14% as of fiscal 2015. Going forward, we expect the market share of NBFCs in to continue to increase with increasing demand.

ECLGS scheme has provided some relief to MSMEs hurt by the pandemic

Given the pain suffered by MSMEs due to the pandemic and the importance of MSMEs in India, the Government undertook several initiatives to support MSMEs and keep them afloat, the most significant of which was the Rs. 3 trillion emergency credit line guarantee scheme (ECLGS) extended to MSMEs in May 2020, and consequently further enhanced by Rs 1.5 trillion in June 2021. Under this scheme, banks and NBFCs were allowed to extend incremental credit of up to 20% of the loans outstanding of MSMEs as on February 29, 2020, subject to these accounts not being delinquent as on February 29, 2020. These loans enjoy credit guarantee cover from the Government. This scheme clearly provided much-needed liquidity to MSMEs that are known to have faced severe working capital crunch during downturns. In May 2021, the scope of the scheme was enhanced to allow incremental credit up to an additional 10% of loans (over the above the 20% of loans allowed previously) to MSMEs adversely impacted by the pandemic.

ECLGS 1.0 May 2020 to Aug 2020	• ECLGS was introduced by providing the MSMEs additional funding of up to Rs. 3 trillion in the form of a fully guaranteed emergency credit line. • **Eligible entities**: All MSME borrower accounts with outstanding credit of up to Rs. 250 million as on February 29, 2020, which were less than or equal to 60 days past due as on that date and with an annual turnover of up to Rs. 1 billion • In August 2020, the upper ceiling of outstanding credit was revised to Rs 0.5 billion and annual turnover to Rs 2.5 billion.
ECLGS 2.0 March 2021	• The Government extended ECLGS through ECLGS 2.0 for 26 sectors identified as stressed due to the Covid-19 pandemic by the Kamath Committee and the healthcare sector. • **Eligible entities:** Entities with outstanding credit above Rs. 0.5 billion and not exceeding Rs. 5 billion as on February 29, 2020, which were less than or equal to 30 days past due as on February 29, 2020 • Annual turnover ceiling was removed from the eligibility criteria for ECLGS 1.0
ECLGS 3.0 Nov 2020	• Government extended the scope of ECLGS to cover business enterprises in Hospitality, Travel & Tourism, Leisure & Sporting sectors which had, as on February 29, 2020, total credit outstanding not exceeding Rs. 5 billion and were less than or equal to 60 days past due as on that date. • The validity of ECLGS was extended up to June 30, 2021 or till guarantees for an amount of Rs. 3 trillion are issued.
ECLGS 4.0 May 2021	• ECLGS scope expanded to cover loans up to Rs 20 million to hospitals/nursing homes/clinics/medical colleges for setting up on-site oxygen generation plants with interest rate capped at 7.5% • Civil Aviation sector included under ECLGS 3.0 • Ceiling of Rs 5 billion of loan outstanding for eligibility under ECLGS 3.0 to be removed, subject to maximum additional ECLGS assistance to each borrower being limited to 40% or Rs 2 billion, whichever is lower. • Borrowers who had availed loans under ECLGS 1.0 of overall tenure of 4 years comprising of repayment of interest only during the first 12 months with repayment of principal and interest in 36 months can increase the tenure to 5 years (repayment of interest only for the first 24 months with repayment of principal and interest in 36 months thereafter) • Additional ECLGS assistance of up to 10% of the outstanding as on February 29, 2020 to borrowers covered under ECLGS 1.0

ECLGS 5.0 June 2021	
	• Additional allocation of Rs 1.5 trillion towards ECLGS scheme; limit of admissible guarantee and loan amount increased above existing level of 20% of outstanding on each loan • Sector wise details to be finalized as per evolving needs • Loan guarantee of Rs 1.1 trillion for Covid-affected sectors: INR 0.5 trillion towards health sector and INR 0.6 trillion towards other covid-affected sectors, including travel and tourism stakeholders • Working capital/personal loans will be provided to people in tourism sector to discharge liabilities and restart businesses impacted due to COVID-19 • Loan guarantee of Rs 7,500 Crore for loans extended by SCBs to MFIs for on lending upto Rs 1.25 lakh to ~25 lakh customers; guarantee cover provided till March 31, 2022 or till guarantees for an amount of Rs 7,500 crore are issued, whichever is earlier

Recently in September 2021, with a view to support various businesses impacted by the second wave of COVID 19 pandemic, the timeline for Emergency Credit Line Guarantee Scheme (ECLGS) has been extended till March 2022 or till guarantees for an amount of Rs 4.5 lakh crore are issued under the scheme, whichever is earlier. Further, the last date of disbursement under the scheme has also been extended to June 2022.

Out of the targeted amount of Rs 4.5 trillion, Rs 2.76 trillion has been sanctioned as of mid-July 2021 of which Rs 2.14 trillion have been disbursed. However, considering the entire universe of around 70 million MSMEs, the proportion of MSMEs that have benefitted remains limited at ~15% (10.9 million) of entire universe. This is because the scheme covered only MSMES having loan exposure to formal financiers as of February 2020. Among the eligible MSMEs, small and micro MSMEs have benefitted the most from ECLGS with 71% share in amount of guarantees issued and 92% share in number of guarantees issued as of February 2021.

The cap of 14% on final interest rate charged to MSME customers for NBFCs meant that customers of many NBFCs, which typically charge more than 14% due to high operating costs and the relatively riskier profile of their borrowers, could not avail the benefits under the ECLGS scheme. As of February 28, 2021 cumulative sanctioned and disbursed amount of loans under the ECLGS scheme stood at Rs 2.46 trillion and Rs 1.81 trillion, respectively. Against the sanctioned amount, guarantees for a total amount of Rs 2.14 trillion to more than 9.2 million borrowers have been issued as on 2nd July 2021. Till June 2021, the banks and financial institutions have sanctioned Rs 2.74 trillion and disbursed Rs 2.14 trillion under the scheme. As of September 24, 2021, loans sanctioned have crossed Rs 2.86 trillion under the scheme.

Modest response to restructuring of MSME loans

Post the Covid-19 pandemic, the central bank constituted a committee which identified 26 sectors for restructuring which included aspects related to leverage, liquidity and debt serviceability to be factored by the lending institutions while finalising resolution plans for borrowers. However, only those borrower accounts were eligible for resolution which were classified as standard, but not in default for more than 30 days with any lending institution as on March 1, 2020.

The RBI has, since 2019, permitted restructuring of temporarily impaired MSME loans (of size up to Rs 25 crore) under three schemes. While public sector banks have actively resorted to restructuring under all the schemes, participation by private sector banks was significant only in the restructuring scheme offered post Covid-19 in August 2020. Despite the restructuring, however, stress in the MSME portfolio remains high, especially in the case of public sector banks. For all scheduled commercial banks together, restructured loans as a proportion of MSME advances stood at 1.7 per cent as of March 2021. For NBFCs, the aggregate stressed assets (including GNPA as well as restructured assets) is estimated at 7.5-8.0% of MSMEs outstanding loan portfolio as of March 2021.

In May 2021, RBI announced a second loan restructuring program for small businesses for a loan amount up to Rs 25 crore to contain the second wave of COVID-19. The restructuring 2.0 is applicable to those who had not availed restructuring earlier but the account should be standard as of 31st March 2021. In June 2021, the exposure limit for availing restructuring was enhanced from Rs 25 crore to Rs 50 crore.

Restructuring of MSME portfolios

Restructuring Scheme	Aggregate Restructured Portfolio (Rs billion)	
	Public sector banks (PSBs)	Private Sector Banks (PVBs)
Restructuring - January 2019 scheme	262	22
Restructuring - February 2020 scheme	59	14
Restructuring - August 2020 scheme	248	110

Source: Financial Stability Report, July 2021

SMA distribution of MSME portfolio (bank group wise)

	PSBs						PVBs				
(%)	0 days past due	SMA-0	SMA-1	SMA-2	NPA		0 days past due	SMA-0	SMA-1	SMA-2	NPA
Mar-20	65.0	6.9	5.7	4.2	18.2		88.6	4.4	1.9	0.7	4.3
Jun-20	63.3	18.2	2.2	2.6	13.7		88.6	7.0	0.9	0.6	2.9
Sep-20	65.9	13.4	3.2	2.6	14.9		87.9	8.1	0.9	0.6	2.6
Dec-20	65.7	7.8	5.6	7.8	13.1		88.1	4.8	2.6	2.4	2.0
Mar-21	60.7	10.6	9.2	3.6	15.9		89.6	3.7	2.4	0.8	3.6

Note: MSME exposures of up to Rs 250 million only are included.

Source: Financial Stability Report (July 2021)

Other measures included making available subordinated debt to MSMEs, equity infusion in export oriented MSMEs (launched in August 2021), steps undertaken to clear MSME dues within 45 days (announced in 26th July 2021) and disallowing global tenders in government tenders up to Rs. 2 billion to support the MSMEs amidst the pandemic. The government also announced the extension of the tenor of the schemes for MSMEs and other entities that are eligible for restructuring as per the Reserve Bank of India guidelines of May 2021.

Small Business Loans of less than Rs 10 lakhs ticket size

Small Business Loans has witnessed fastest growth within the overall MSME portfolio

In this section, we have classified all loans with ticket size lower than or equal to Rs 10 lakhs extended in the name of the individual to MSMEs, micro-entrepreneurs, and self-employed individuals irrespective of the turnover of the entity, as small business loans. Therefore, loans given out to enterprises or companies in the name of the entity and loans reported in the commercial bureau of credit information companies (CICs), even if they are below Rs 10 lakhs ticket size, are excluded from our market size.

CRISIL Research estimates outstanding small business loans given out by banks and NBFCs to be around Rs 1.7 trillion as of March 2021.

Small business loans grew at a fast pace with portfolio registering a CAGR of 36% over fiscal 2017 and 2020. Over the last few years, expansion in branch network, more data availability and government initiatives like GST, UDYAM, and increasing thrust to adoption of digital payments has led to increasing focus of lenders, especially the NBFCs, on the underserved segment of MSME customers including individuals and micro-entrepreneurs. Loan portfolio of Five Star Business Finance grew at a 99% CAGR over the same period (fiscal 2017 and 2020) to reach Rs 38 billion.

In fiscal 2021, the nationwide lockdown to contain the spread of the pandemic disrupted economic activity, hurt demand, impacted working capital needs and supply chain along with future investments and expansions. Domestic supplies and supplies from imports also suffered, affecting both, their availability and cost. Contractual and wage labour were also hit due to lower demand and layoffs. MSMEs and businesses in the sectors such as hotels, tourism, logistics, construction, textiles and gems and jewellery suffered the most during the first half of the fiscal. Businesses in the retail sector, especially those catering to daily usage goods and everyday cash and carry businesses such as grocery shops, fruits and vegetables sellers, etc., however, fared relatively better as their availability close to the residences of customers' increased the demand for their services.

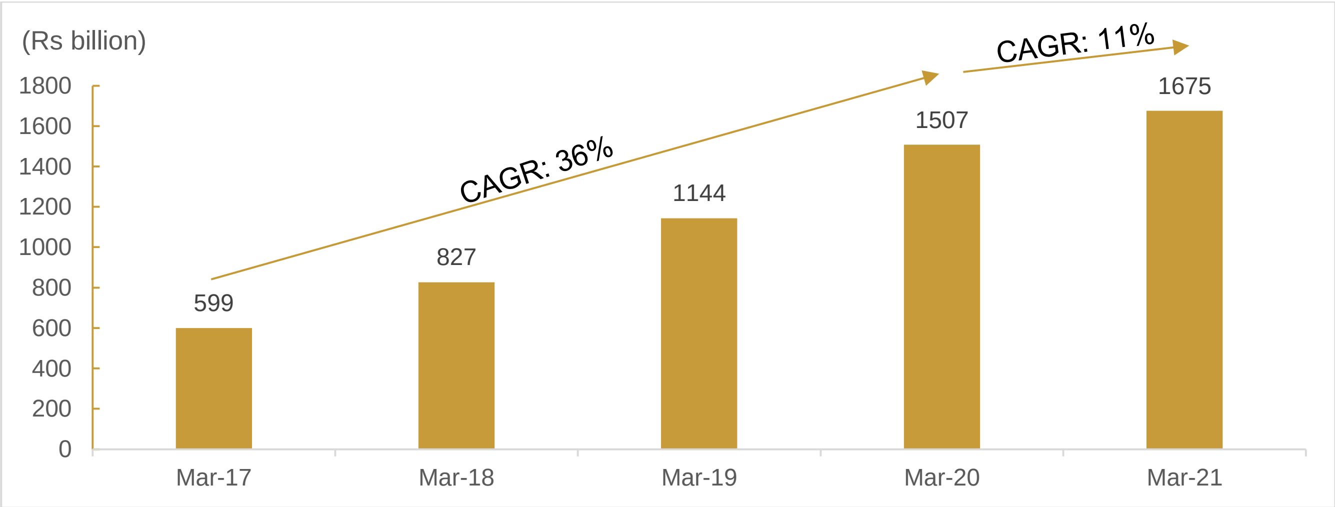
Although the demand for small business loan to meet liquidity and cash requirements existed in months of pandemic, lenders have been watchful and have been going slow on disbursements since the onset of the pandemic. Disbursements of small business loans of lower than Rs 10 lakhs ticket size declined by as much as 57% on a year-on-year basis to Rs 468 billion in fiscal 2021. As a result, small business loans portfolio of banks and NBFCs grew at a slower pace of 11% in fiscal 2021 compared to the past. Five Star Business Finance witnessed a 14% growth in its loan portfolio in fiscal 2021 to touch Rs 44 billion as of March 2021.

Given the pain suffered by MSMEs due to the pandemic and the importance of MSMEs in India, the government undertook several initiatives to support MSMEs to keep them afloat, the most significant of which was the Rs 3 trillion emergency credit line guarantee scheme (ECLGS), which was aimed at pushing banks and NBFCs to extend further credit to MSMEs to meet their liquidity and funding needs with the government providing a back stop guarantee against such loans. Under this scheme, banks and NBFCs were allowed to extend incremental credit of up to 20% of the loans outstanding of MSMEs as on February 29, 2020 subject to these accounts not being delinquent as on February 29, 2020. This scheme clearly provided much-needed liquidity to MSMEs that are known to have faced severe working capital crunch during downturns. Recently in September 2021, the timeline for Emergency Credit Line Guarantee Scheme (ECLGS) has been extended till March 2022. As of September 24, 2021, loans sanctioned have crossed Rs 2.86 trillion under the scheme. In June 2021, the government increased the overall admissible guarantee limit from Rs 3.0 trillion to Rs 4.5 trillion. Along with this, the limit of admissible guarantee and loan amount was increased above the existing level of 20% of outstanding.

The sharp decline in disbursements of loans less than Rs 10 lakhs ticket size in fiscal 2021 indicates that several MSME borrowers availing loans of this ticket size probably did not avail significant credit under the ECLGS scheme. The cap on interest rates that could be charged to end-borrowers under ECLGS – 9.25% in case of banks and 14% in case of NBFCs – may also have limited the lender participation in the scheme for this ticket size of loans.

Other measures taken by the government to support MSMEs amidst the pandemic include making available subordinated debt to MSMEs, equity infusion in MSMEs, steps undertaken to clear MSME dues, and disallowing global tenders in government tenders up to Rs 2 billion to support the MSMEs.

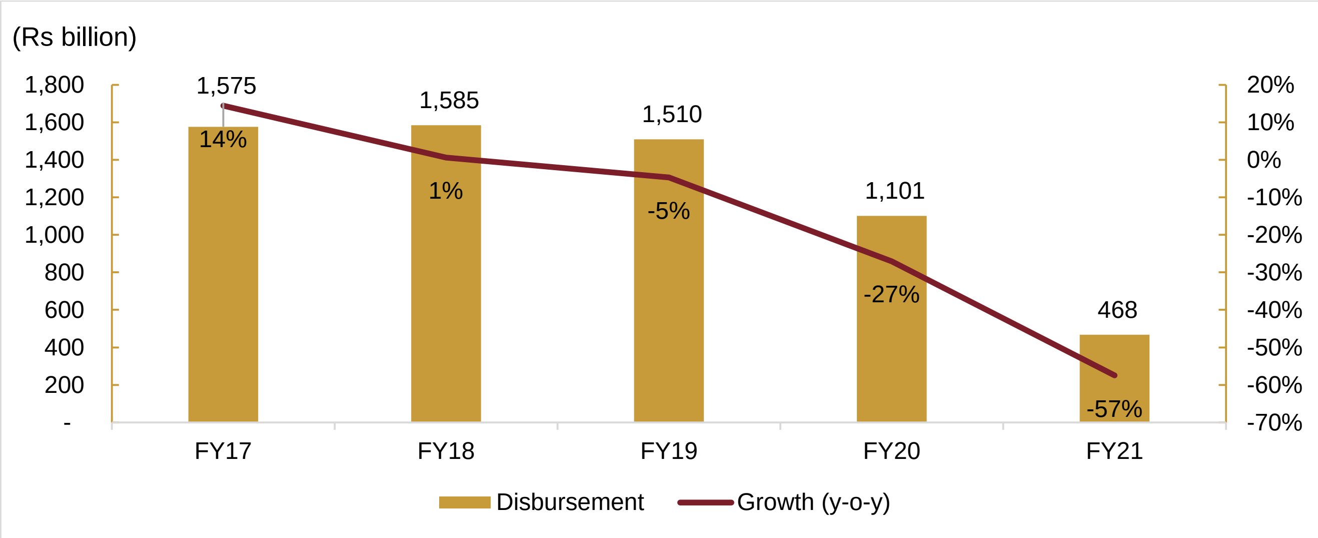
Small Business Loans grew at 36% CAGR between fiscal 2017 and 2020, before slowing down in fiscal 2021 amidst the Covid-19 pandemic



Note: Above data includes business loans given to MSMEs upto Rs 10 lakhs ticket size and reported in consumer bureaus of CICs

Source: CRIF Highmark, CRISIL Research

Disbursements declined due to Covid-19 pandemic



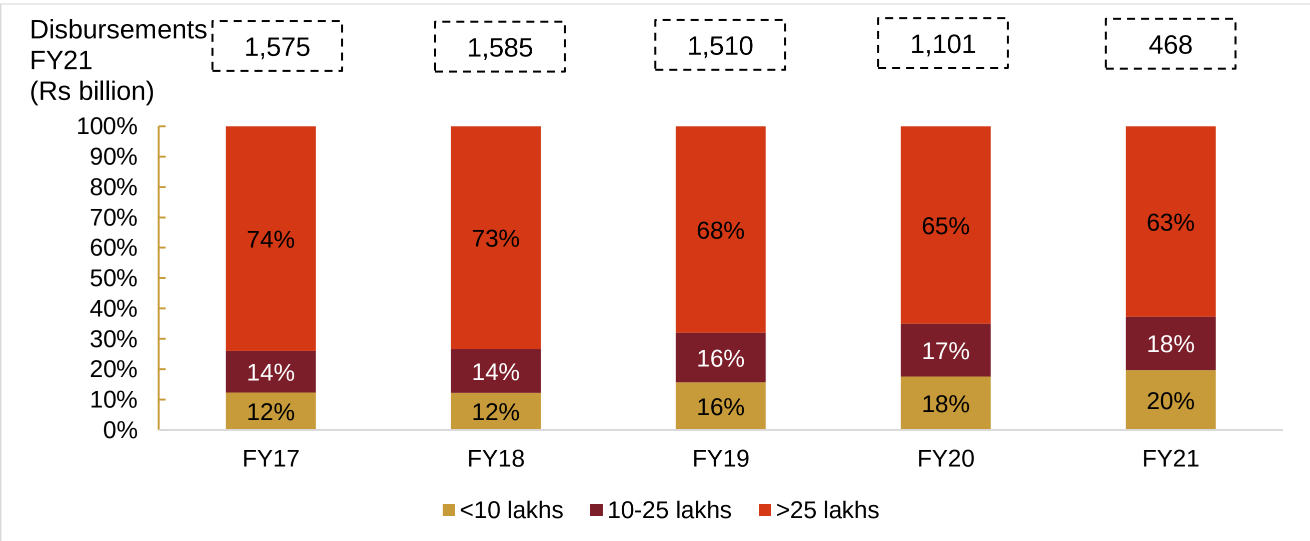
Note: Above data includes business loans given to MSMEs upto Rs 10 lakhs ticket size and reported in consumer bureaus of CICs

Source: CRIF Highmark, CRISIL Research

Small value business loans gained market share over the years

With increase in data availability and enhanced use of technology and experience gained across several cycles while lending to the same customer segment, lenders have increased focus on targeting the underserved segment within the small business loans market. This has led to a continued increase in share of smaller ticket size loans in the overall lending pie. The demand-supply gap, as outlined earlier, is also the highest in this segment, indicating significant business opportunities for financiers with a deep understanding of the target customer segment across focus geographies, ability to underwrite credit and the right unit economics. The market share of small business loans with ticket size less than Rs 10 lakhs in overall disbursements has increased from 12% in fiscal 2017 to 20% in fiscal 2021. Loans outstanding with relatively smaller ticket sizes have grown at a much higher pace than larger ticket size loans between fiscal 2017 and fiscal 2021.

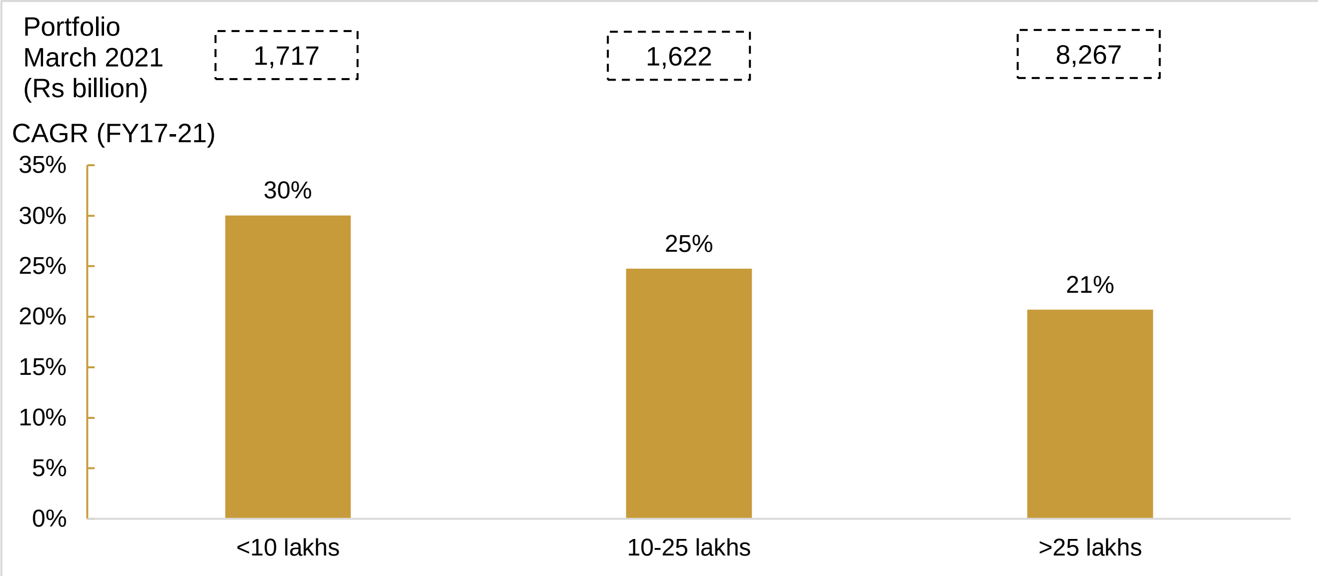
Share of smaller ticket size loans in disbursements lower than Rs 10 lakhs increasing over past four years



Note: Above data includes business loans reported in consumer bureaus of CICs

Source: CRIF Highmark, CRISIL Research

Lower ticket small business loan portfolio grew at higher CAGR compared to higher ticket size loans



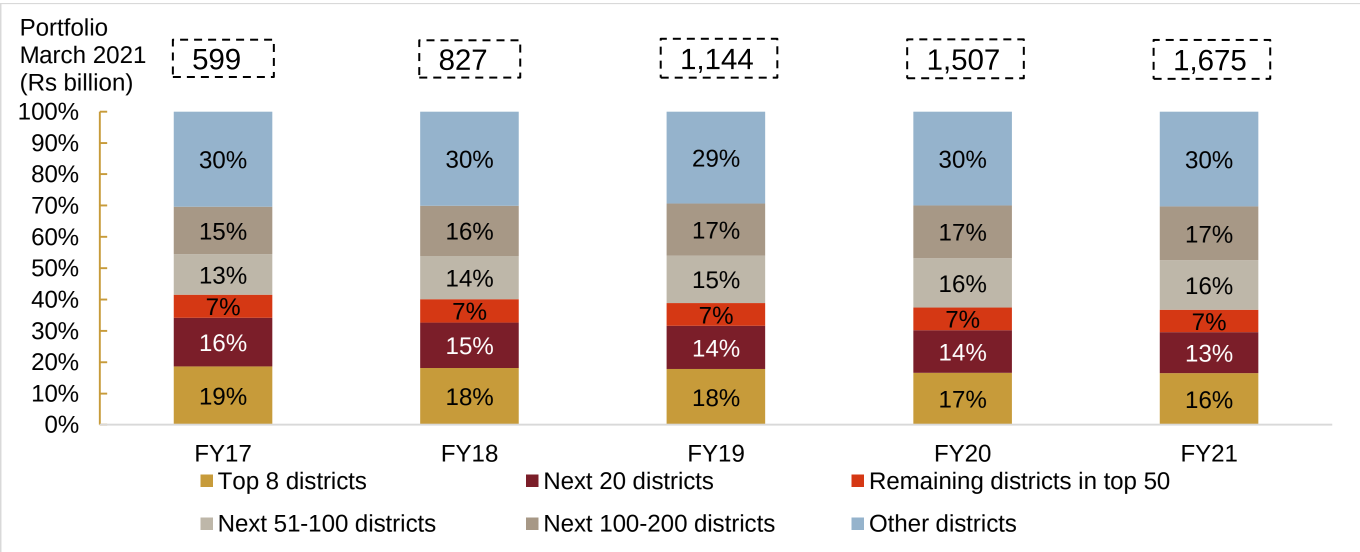
Note: Above data includes business loans reported in consumer bureaus of CICs

Source: CRIF Highmark, CRISIL Research

Penetration on small business loans is increasing in smaller cities

Over the years, share of smaller cities have increased in the small business loans segment owing to increasing penetration of financial services and players focussing on the underserved customer segment. Share of loans outside top 50 cities has increased from 58% in fiscal 2017 to 64% in fiscal 2021. Small business loans portfolio in smaller cities has grown at relative higher CAGR compared to that in top 50 cities.

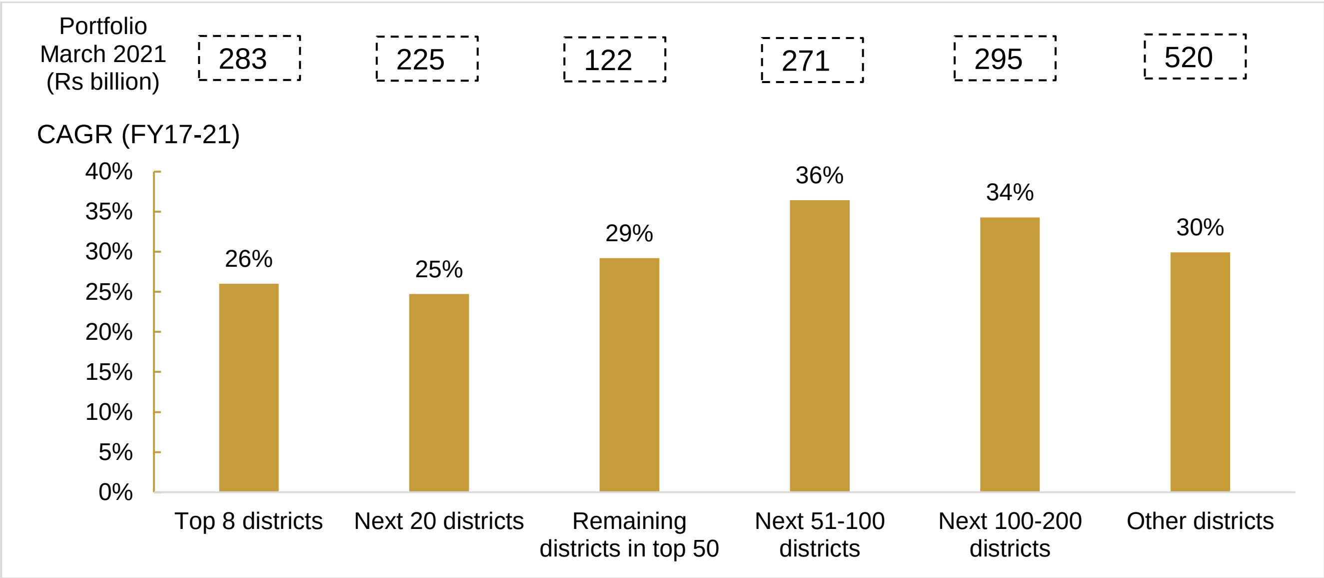
Share of small business loans portfolio in smaller cities increasing over past four years



Note: Above data includes business loans given to MSMEs upto Rs 10 lakhs ticket size and reported in consumer bureaus of CICs
1) Classification of districts is done based on population as per Census 2011.
2) Mumbai Metropolitan Region (MMR), National Capital Region (NCR), Bengaluru and Kanpur have each been considered as a district.
3) MMR includes Thane and Mumbai, NCR includes Delhi, Gurugram, Gautam Buddha Nagar, Ghaziabad and Faridabad, Bengaluru includes Bangalore Urban and Bangalore Rural, Kanpur includes Kanpur Nagar and Kanpur Dehat

Source: CRIF Highmark, CRISIL Research

Small business loans portfolio in smaller cities grew at a higher CAGR than that in top 50 cities



Note: Above data includes business loans given to MSMEs upto Rs 10 lakhs ticket size and reported in consumer bureaus of CICs

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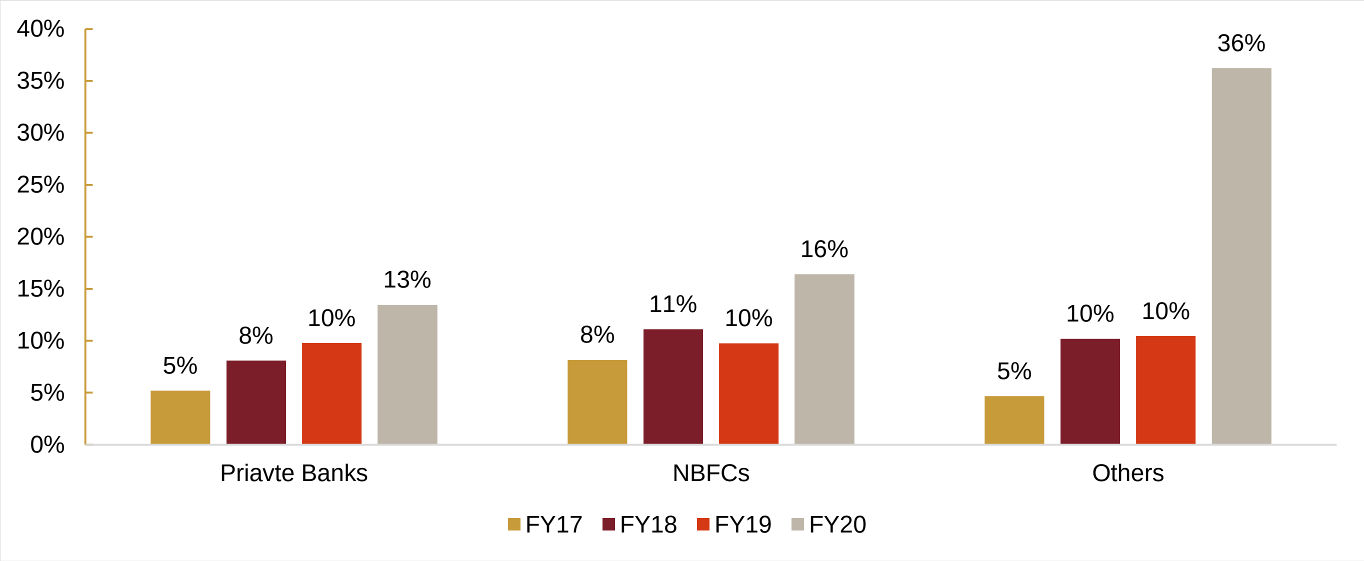
Source: CRIF Highmark, CRISIL Research

Share of new to credit customers has been increasing in small business loans segment

Share of new to credit (NTC) customers has increased over the years, indicating increasing penetration of small business loans. Overall, share of new to credit customers in small business loan segment with ticket size less than Rs 10 lakhs has increased from 9% in fiscal 2017 to 25% in fiscal 2020. Among player groups, public sector banks have highest share of NTC customers followed by NBFCs. Share of new to credit customers is much higher in small business loans of ticket size less than Rs 10 lakhs compared to that of ticket size more than Rs 10 lakhs across players. In fiscal 2021, the proportion of NTC customers in small business loans segment is estimated to have further increased to around 34%.

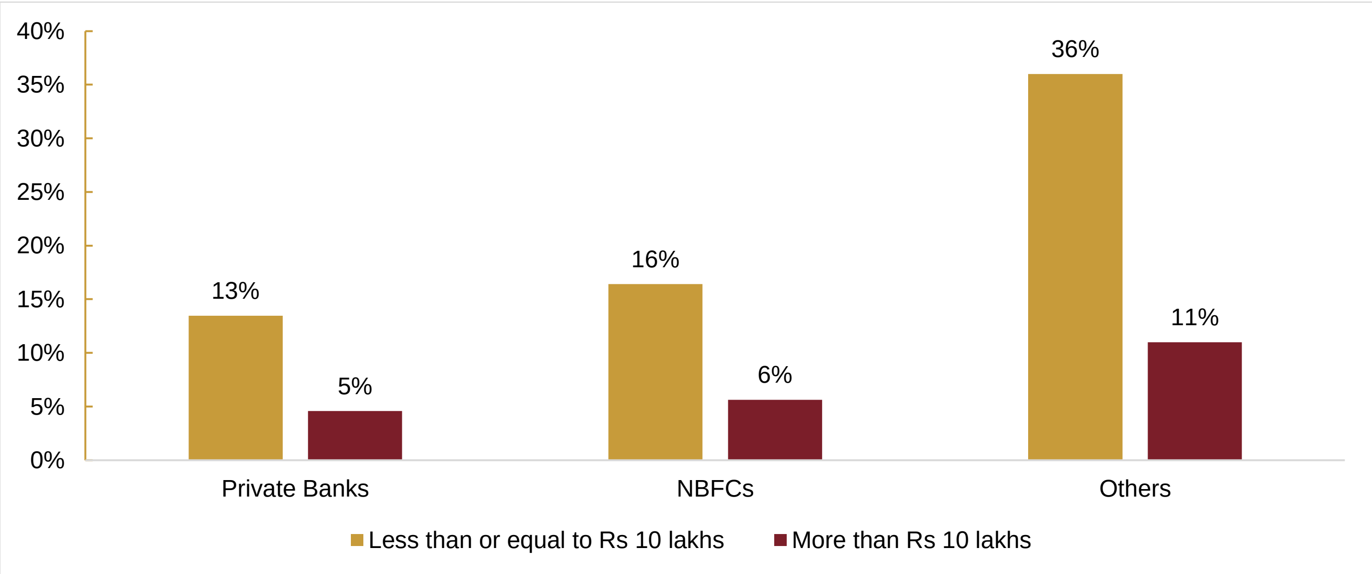
Share of new to credit customer increasing across players



Note: Above data includes business loans reported in consumer bureaus of CICs, NTC defined as loans with borrower vintage <= 12 months, Others includes player groups like Small Finance Banks, Foreign Banks, Regional Rural Banks

Source: CRIF Highmark, CRISIL Research

Share of new to credit customers much higher for smaller ticket size loans (Fiscal 2020)



NTC defined as loans with borrower vintage <= 12 months

Note: Above data includes business loans reported in consumer bureaus of CICs

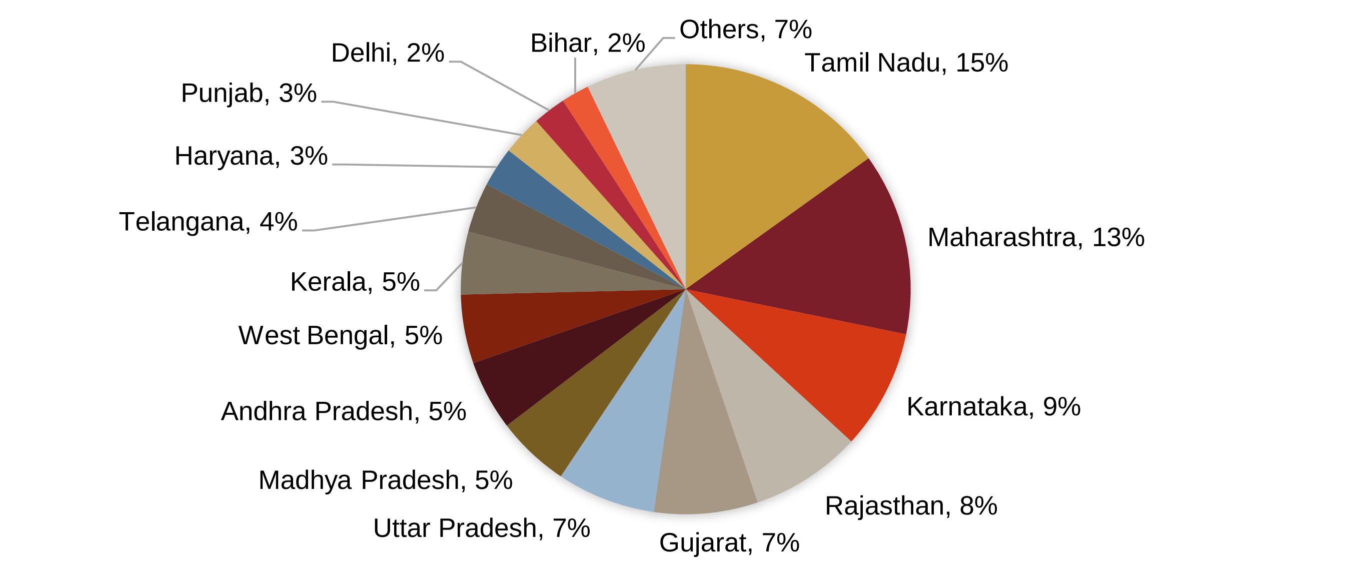
Source: CRIF Highmark, CRISIL Research

State-wise analysis

The small business loans segment has been growing strongly with a four-year CAGR of 29% between fiscal 2017 and 2021. However, there are wide variations across states and within various districts in the same state as well, which indicates latent opportunity for offering loans to unserved or underserved customers. Based on the value of small business loans lower than Rs 10 lakhs ticket size outstanding, the top 15 states accounted for 93% of the market size in this segment as of March 2021. Tamil Nadu tops the list with the highest share of 15%, followed by Maharashtra (13%), Karnataka (9%), Rajasthan (8%) and Gujarat (7%).

In the last four years, among the top 15 states, small business loans outstanding has grown at the fastest clip in West Bengal, which exhibited growth of 57% CAGR, followed by Andhra Pradesh (40%) and Rajasthan (33%).

Top 15 states account for 93% of small business loans portfolio (March 2021)



Note: Above data includes business loans given to MSMEs upto Rs 10 lakhs ticket size and reported in consumer bureaus of CICs

Source: CRIF Highmark, CRISIL Research

Among the top 15 states, in Rajasthan, Madhya Pradesh, Telangana and West Bengal, the top five districts (based on outstanding) within the states have more than 80% concentration of credit outstanding and in Maharashtra, Karnataka, Gujarat and Kerala, this concentration in the top five districts is more than 60%. In contrast, the dispersion in loans across districts is far higher in Tamil Nadu and Uttar Pradesh, with the top 5 districts accounting for 54% and 52% of outstanding loan, respectively, as of March 2021. This indicates wide variations in credit availability across districts in the same state as well.

Amongst player groups, the share of NBFCs is highest at 67% in Rajasthan followed by Telangana (53%), Gujarat (49%) and Madhya Pradesh (49%).

State-wise small business loans (of lower than Rs 10 lakhs ticket size)

State	No. of districts	Small Business Loans outstanding as of March 2021 (Rs billion)	Share of state in small business loans market (March 2021)	Growth in Small Business Loans outstanding (CAGR: FY17-21)	Top 5 districts based on small business loans outstanding	Share of top 5 districts in small business loans outstanding	Share of NBFCs in small business loans market (March 2021)

Tamil Nadu	32	253.1	15.2%	25%	Thiruvallur, Kancheepuram, Chennai, Coimbatore, Salem	37%	42%
Maharashtra	34	219.5	13.2%	31%	Pune, Thane, Mumbai, Nashik, Kolhapur	54%	45%
Karnataka	31	144.3	8.7%	30%	Bangalore, Belgaum, Mysore, Tumkur, Davanagere	52%	37%
Rajasthan	32	133.8	8.0%	33%	Jaipur, Ajmer, Jodhpur, Bhilwara, Alwar	46%	67%
Gujarat	26	124.8	7.5%	28%	Ahmadabad, Surat, Rajkot, Vadodara, Mahesana	60%	49%
Uttar Pradesh	72	119.0	7.1%	25%	Ghaziabad, Lucknow, Agra, Meerut, Saharanpur	30%	33%
Madhya Pradesh	50	88.1	5.3%	33%	Indore, Bhopal, Ujjain, Dewas, Dhar	44%	49%
Andhra Pradesh	14	84.6	5.1%	40%	Visakhapatnam, Krishna, East Godavari, Guntur, West Godavari	61%	50%
West Bengal	19	82.8	5.0%	57%	Kolkata, North Twenty Four Parganas, South Twenty Four Parganas, Barddhaman, Murshidabad	49%	21%
Kerala	16	75.4	4.5%	25%	Ernakulam, Kottayam, Thiruvananthapuram, Thrissur, Malappuram	62%	23%
Telangana	9	60.1	3.6%	26%	Hyderabad, Rangareddy, Karimnagar, Nalgonda, Warangal	76%	53%
Punjab	20	47.8	2.9%	23%	Ludhiana, Jalandhar, Amritsar, Patiala, Sahibzada Ajit Singh Nagar	58%	36%
Haryana	19	48.0	2.9%	28%	Faridabad, Gurgaon, Panipat, Karnal, Yamunanagar	48%	43%
Delhi	8	39.9	2.4%	25%	North West Delhi, South Delhi, West	78%	46%

					Delhi, East Delhi, South West Delhi		
Bihar	39	33.6	2.0%	29%	Aurangabad, Patna, Muzaffarpur, Gaya, Begusarai	45%	19%
Odisha	30	25.9	1.6%	34%	Khordha, Cuttack, Baleshwar, Puri, Ganjam	49%	23%
Assam	23	21.2	1.3%	29%	Kamrup, Nagaon, Cachar, Sonitpur, Sivasagar	40%	11%
Uttarakhand	14	16.2	1.0%	17%	Dehradun, Hardwar, Udham Singh Nagar, Nainital, Garhwal	91%	39%
Chhattisgarh	19	16.8	1.0%	30%	Raipur, Durg, Bilaspur, Janjgir - Champa, Korba	66%	43%
Jharkhand	23	12.8	0.8%	33%	Ranchi, Purbi Singhbhum, Dhanbad, Bokaro, Hazaribagh	66%	22%
Himachal Pradesh	12	7.4	0.4%	17%	Kangra, Mandi, Solan, Shimla, Kullu	74%	15%
Goa	2	2.6	0.2%	21%	North Goa, South Goa	100%	19%
Jammu & Kashmir	16	3.0	0.2%	3%	Jammu, Srinagar, Anantnag, Reasi, Kathua	74%	15%
Tripura	4	2.7	0.2%	87%	West Tripura, South Tripura, North Tripura, Dhalai	100%	6%
Manipur	9	1.6	0.1%	63%	Imphal West, Imphal East, Thoubal, Senapati, Churachandpur	83%	4%
Meghalaya	6	1.0	0.1%	25%	East Khasi Hills, West Khasi Hills, West Garo Hills, West Jaintia Hills, Ribhoi	96%	7%
Mizoram	7	0.3	0.0%	53%	Aizawl, Lunglei, Champhai, Kolasib, Lawngtlai	92%	3%
Nagaland	10	0.7	0.0%	24%	Dimapur, Kohima, Mokokchung, Wokha, Zunheboto	98%	4%
Sikkim	4	0.5	0.0%	36%	South Sikkim, North Sikkim, West Sikkim, East Sikkim	100%	7%
Arunachal Pradesh	13	0.2	0.0%	17%	Papum Pare, Kurung Kumey,	85%	11%

					Lohit, East Siang, Lower Subansiri		

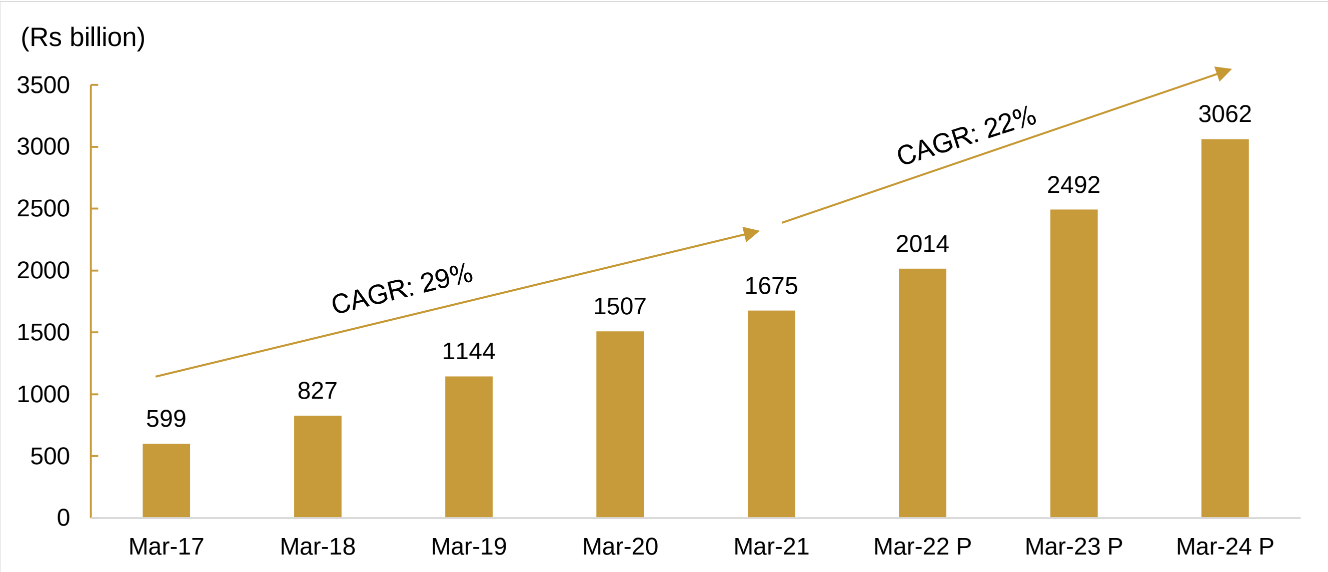
*Note: Above data includes business loans given to MSMEs upto Rs 10 lakhs **ticket size** and reported in consumer bureaus of CICs. Number of districts are as reported in the bureau data.*

Source: CRIF Highmark, CRISIL Research

Small business loans will continue to grow at a strong pace

There is a huge demand supply gap in small business loan segment. With increasing presence of small business loans in smaller cities and rising focus of lenders on underserved target customer segment, loan portfolio is expected to see a strong growth in future. Going forward, CRISIL Research expects the small business loans portfolio to grow at 22% CAGR over fiscal 2021 and 2024 aided by increasing lender focus and penetration of such loans, enhanced availability of data increasing lender comfort while underwriting such loans, enhanced use of technology, newer players entering the segment, and continued government support.

Small Business Loans of less than Rs 10 lakhs ticket size to grow at 22% CAGR between fiscal 2021 and 2024



Note: Above data includes business loans given to MSMEs upto Rs 10 lakhs ticket size and reported in consumer bureaus of CICs, P-Projected

Source: CRI Highmark, CRISIL Research

Growth drivers

High credit gap in the target customer segment

Less than 15% of the 70 million odd MSMEs have access to formal credit in any manner as of March 2021. High risk perception and the prohibitive cost of delivering services physically have constrained traditional institutions' ability to provide credit to underserved or unserved MSMEs, small business owners and self-employed individuals historically. As a result, they are either self-financed or take credit from the unorganised sector. This untapped market offers huge growth potential for financial institutions. As stated earlier, the credit gap was estimated at around Rs 58.4 trillion as of 2017 *(Source: IFC report named Financing India's MSMEs released in November 2018)*, and is estimated to have widened further to around Rs 79 trillion as of fiscal 2021. The credit gap is the highest in the case of sole proprietorship firms, which are estimated to account for ~94% of the MSME universe in India, as per the IFC report.

Increased data availability and transparency

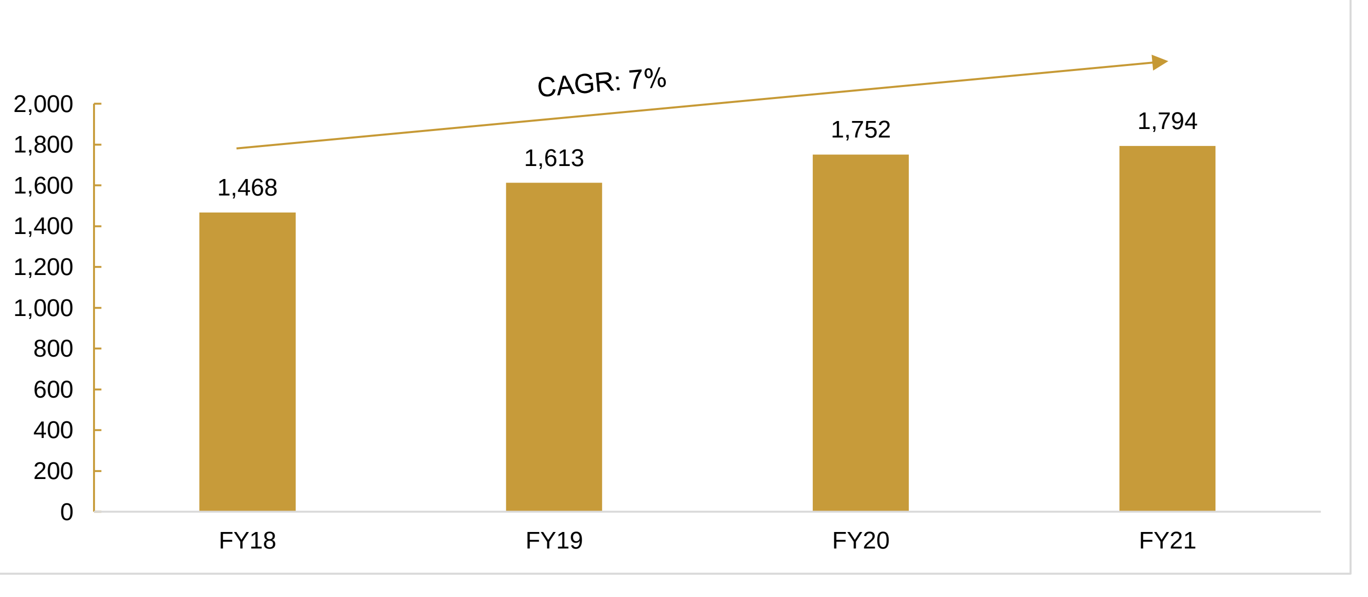
With increased digital initiatives by the MSMEs, the shift towards their formalisation and digitisation has created a plethora of data points for lenders that would help improve the efficacy of credit assessment and gradually enable provision of credit to hitherto underserved customer segments. For example, the quantum of retail digital payments has catapulted from Rs 140 trillion transaction in fiscal 2017 to Rs 353 trillion transactions in fiscal 2021. Within UPI, the quantum of person-to-merchant payments has zoomed from Rs 1.2 trillion transaction in April to July 2020 to Rs 3.8 trillion transactions in April to July 2021. This increase has created a digital footprint of customers, which can be potentially used for credit decision making, along with other relevant parameters such as customer demographics, business details, credit score, and personal situation of the borrower. While new data points are aiding customer assessment, some players like Five Star Business Finance perform credit assessment without any documentation or supporting data points owing to the customer profile such players cater to.

Growth in branch network of players in small business loans segment

Over past few years, players offering small business loans segment have expanded their branch network with the intent to serve a larger customer base. To illustrate, the cumulative branch network of five small business lenders (Five Star, Sriram City Union, Vistaar, Veritas and Aye) has expanded at a 7% CAGR between fiscal 2018 and 2021, even while the NBFC universe and the economy were impacted by the IL&FS crisis, a slowdown in growth. In fiscal 2020 and the Covid-19 pandemic. Five Star Business Finance witnessed a CAGR of 26% over the same period; it had 262 branches as of March 2021.

In the future also, we expect lenders with a strong focus on MSME lending and healthy competitive positioning to continue to invest in branch expansion. With increasing branch network, customer acquisition and credit penetration of small business loans will also increase.

Number of branches have grown at 7% CAGR over fiscal 2018 and 2021



Note: The above data includes branches for Five Star Business Finance, Shriram City Union Finance, Vistaar Finance, Veritas Finance and Aye Finance

Source: Company Reports, CRISIL Research

Reduction in risk premiums due to information asymmetry

In the absence of reliable information about small businesses, it becomes difficult for lenders to assess the creditworthiness of the borrower. Hence, lenders often charge a credit risk premium from these customers, leading to higher interest rates. By leveraging technology and using a combination of traditional data (bureau data, financial statements, credit score), non-traditional data (payments, telecom, provident fund contribution and psychometric data), and government data (Aadhaar, GST), lenders would be able to gain greater insight into their customers' data, thereby increasing the accuracy of customer assessments. This would reduce the level of asymmetry in information and could lower the credit risk premium over a period of time.

Increasing competition with entry of new players and partnerships between them

More players in consumer-facing businesses with a repository of data (such as e-commerce companies and payment service providers) are expected to enter the lending business, intensifying competition. For example, In June 2018, Amazon India launched a platform for lenders and sellers, wherein sellers can choose loan offers from various lenders at competitive rates. In August 2021, Facebook partnered with Indifi Technologies to provide loans to small businesses that advertise on its platform. Incumbent traditional lenders will increasingly leverage the network of their partners and/or digital ecosystem to cross-sell products to existing customers, tap customers of other lenders, and also cater to new-to-credit customers. This will expand the market the small busines loans.

Reduction in TAT and increased use of technology

With the availability of multiple data points and technological advancement, TAT for lending to MSMEs has been continuously declining. This too will drive the demand for MSME loans.

Government initiatives

Credit Guarantee Fund Scheme extended to cover NBFCs

One of the major reasons why MSMEs are credit-starved is the insistence by banks or financial institutions for the provision of collateral against loans. Collaterals are not easily available with such enterprises, leading to a high risk perception and higher interest rates for these MSMEs. In order to address this issue, the government launched the Credit Guarantee Fund Scheme under the aegis of the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) in order to make collateral-free credit available to micro and small enterprises.

In January 2017, the scheme was extended to cover systemically important NBFCs as well. Key eligibility criteria for this scheme are:

1) NBFCs should be registered with RBI and meet specified prudential norms;

2) the NBFC should have made a profit for the three preceding fiscals at the time of enrolment;

3) the NBFC should be lending to micro and small enterprises with minimum 5 years of lending experience, minimum Rs 100 crore of MSE loan portfolio, NPA level below 5% for MSE portfolio and average recovery ratio of 90% for preceding three fiscals at the time of enrolment and

4) it should have long-term credit rating of at least BBB. The overall limit under the scheme was also been enhanced to Rs 20 million.

Guarantees approved under CGTMSE

Year	Number of guarantees approved	Amount of guarantees approved (rs billion)
FY19	**435,520**	**302**
FY20	**846,650**	**459**
FY21	**835592**	**369**

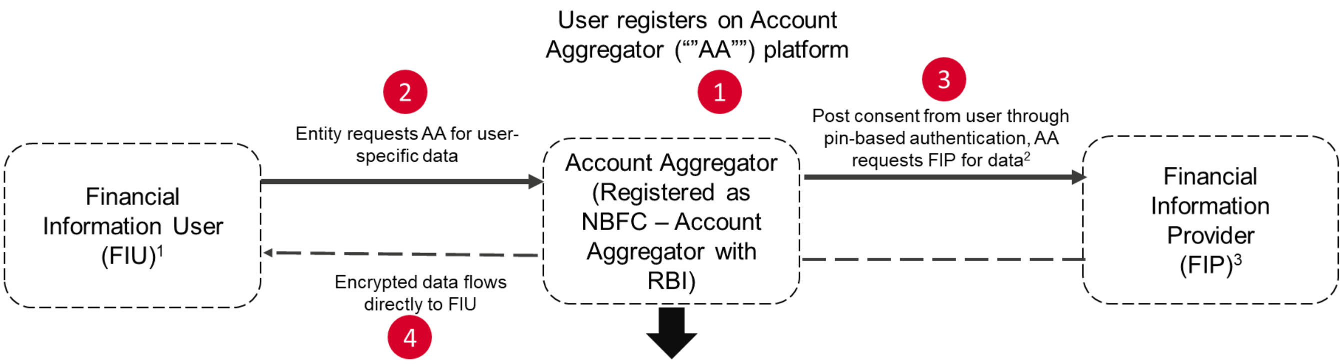
Source: CGTMSE, CRISIL Research

Government initiatives addressing structural issues in the MSME market

The government has unveiled a number of initiatives aimed at addressing some of the structural issues plaguing small business lending segment. These include granting licences to account aggregators, the Pradhan Mantri Mudra Yojana (PMMY), unveiling Trades Receivables Discounting System (TReDS) platforms and the implementation of GST.

Licensing account aggregators

The RBI launched the account aggregator system on September 2, 2021, which has the potential to transform the MSME finance space once there is widespread adoption amongst the lending community. Four account aggregators also announced the launch of their apps on the same day which include OneMoney, FinVu, CAMSFinServ and NADL. Account aggregators are essentially non-banking financial companies, licensed by RBI, that act as an intermediary to collect and consolidate data from all Financial Information Providers (FIP) that hold users' personal financial data like banks and share that with Financial Information Users (FIU) like lending agencies or wealth management companies that provide financial services.These account aggregators would provide granular insights to lenders into customers' financial assets and their borrowing history centrally, based on customer consent. Inclusion of additional data such as electricity bill payments and mobile recharges/bill payment data under the purview of account aggregators would further enhance its utility.



1. FIU is any registered entity[4] which requires access to user data; once registered as an FIU, the entity will have access to data of all users registered on AAs (basis their consent); the consent will be valid for a period of time as permitted by the user
2. The user has complete control over his/her available FIP data which can be shared with FIU; for example, a user who has three bank accounts can decide to share data from only one bank account
3. The current details that can be sourced through AA portal/app are bank accounts, deposits, mutual funds, insurance policies and pension funds

Note: [4] Registered with any one of the regulator – SEBI, RBI, IRDAI, PFRDA

Source: CRISIL Research

Some of the other government and regulatory initiatives are detailed below:

- **UDYAM registration**: Paperless and online registration process for MSMEs with an aim to promote ease of doing business. It aims to increase coverage of MSMEs to avail benefits of various schemes of central/ state Governments

- **Stand-up India**: It facilitates bank loans between Rs. 1 million and Rs. 10 million to at least one scheduled caste or scheduled tribe borrower and at least one woman borrower per bank branch for setting up a Greenfield enterprise. As of March 31, 2021, 113,441 applications amounting to Rs 254 billion have been sanctioned under the scheme.

- **Make in India**: Launched with an intention to make India a global manufacturing hub, which in turn will provide employment to numerous youths in the country

- **Mudra loans**: To fulfil funding requirement of MSMEs who were earlier left out by financial institutions; credit guarantee support also offered to financiers. Over the last 5 years ended Fiscal 2021, disbursements to the tune of Rs. 14.96 trillion have taken place under Pradhan Mantri Mudra Yojana (PMMY).

- **59 minute loan**: Online marketplace that provides in-principle approval to MSME loans up to Rs. 10 million in 59 minutes. Uses advanced algorithms to analyse data from multiple data points, such as GST returns and banking, without human intervention. As of March 31, 2021, Rs 621 billion has been disbursed to 214,534 loan accounts.

- **UPI 2.0**: Real-time system for seamless money transfer from account. Enhances trust in digital transactions for customers as well as merchants. Has features, such as linking to overdraft account and invoice in the inbox

- **TReDS**: Institutional mechanism to facilitate financing of trade receivables of MSMEs from corporates and other buyers through multiple financiers. Provides better price recovery and reduces working capital need of MSMEs

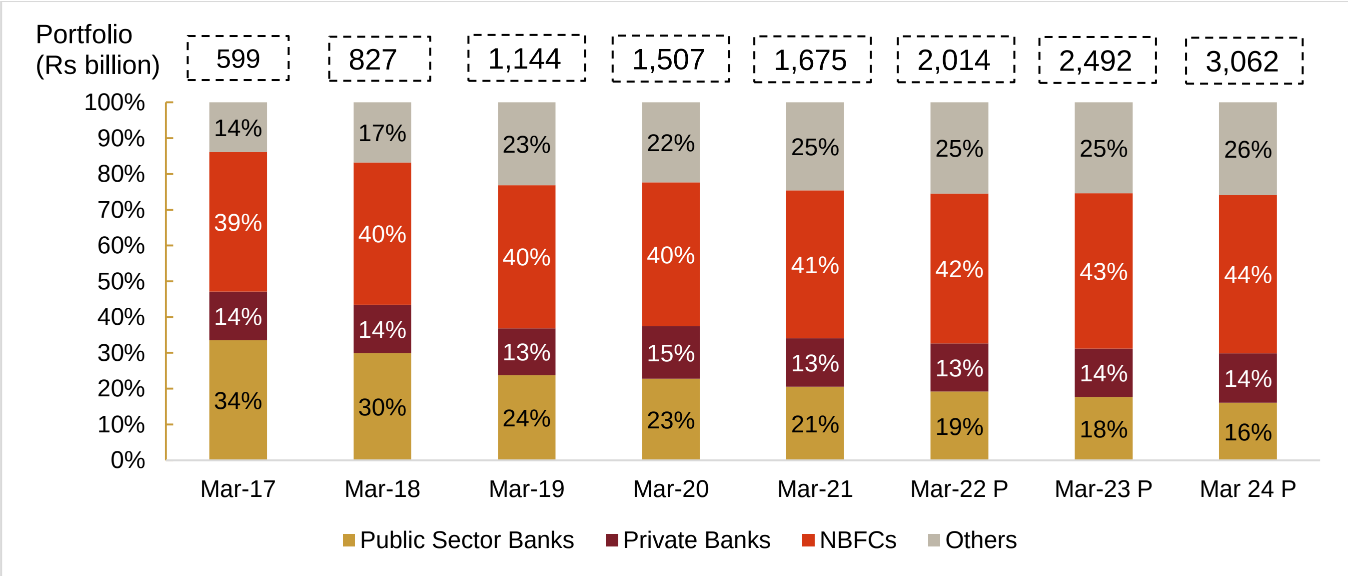
- **Factoring to support more participation from NBFCs:** In an amendment to Factoring Regulation Act, 2011, the Lok Sabha passed the Factoring Regulation (Amendment) Bill in July 2021. The amendment allows all NBFCs to provide credit facilities though factoring on the TReDS portal; previously, apart from banks only NBFC – Factors were allowed to carry out the factoring business. The Bill also allows the concerned TReDS platform to register charge directly with CERSAI on behalf of the factors using the platform.

NBFCs increasing their presence in the small business loans segment

NBFCs have managed to carve out a strong presence in small business loans due to their focus on serving the needs of the customer segment, faster turnaround time, customer service provided and expansion in geographic reach. As of fiscal 2021, the cumulative market share of NBFCs in small business loans of less than Rs 10 lakhs ticket size outstanding is estimated to be around 41%, which is higher than any other player groups.

Over the years, the small business loan portfolio of NBFCs have grown at a faster rate than the overall small business loan portfolio at a systemic level, clocking a CAGR of 31% over fiscals 2017 and 2021. Market share of NBFCs remained stable between fiscal 2018 and 2019 due to demonetisation and the NBFC liquidity crisis but has increased subsequently. The cumulative market share of NBFCs increased by 2 percentage points over fiscals 2017-2021. Going forward, we expect the market share of NBFCs in this segment to continue to increase and touch 44% by fiscal 2024.

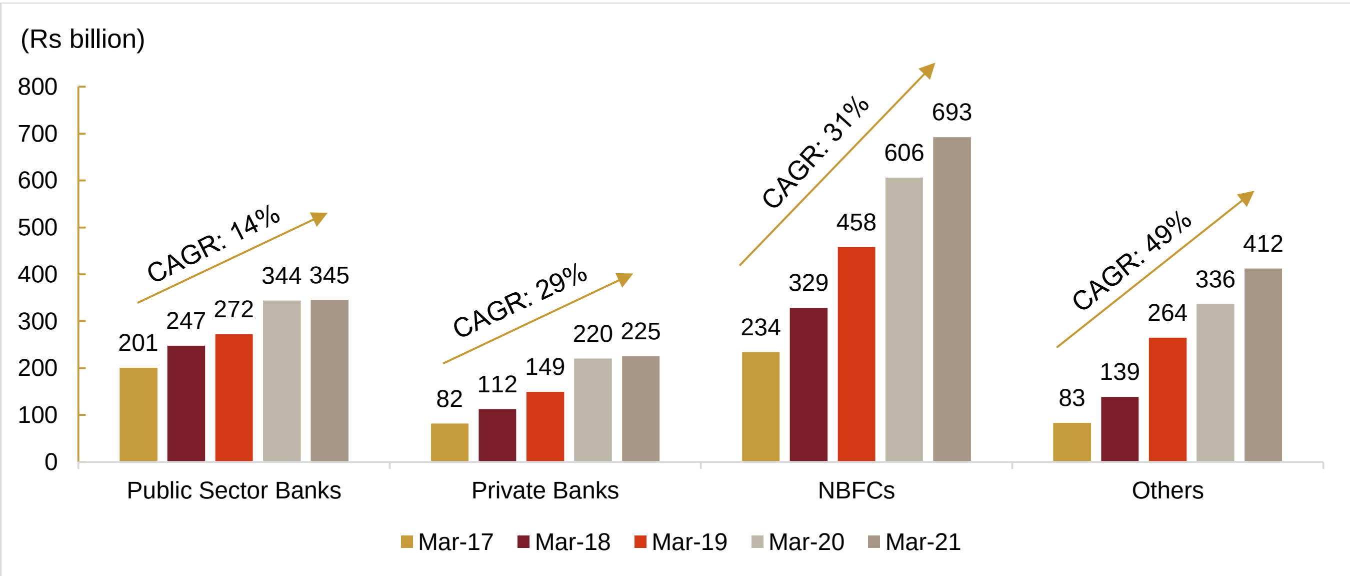
NBFCs continue to gain market share from banks in small business loans less than Rs 10 lakhs ticket size



Note: (1) Above data includes business loans given to MSMEs upto Rs 10 lakhs ticket size and reported in consumer bureaus of CICs, (2) Others include foreign banks, co-operative banks and regional rural banks, (3) P-Projected

Source: CRIF Highmark, CRISIL Research

NBFCs have grown at faster pace compared to PSBs and private banks in small business loans less than Rs 10 lakhs ticket size

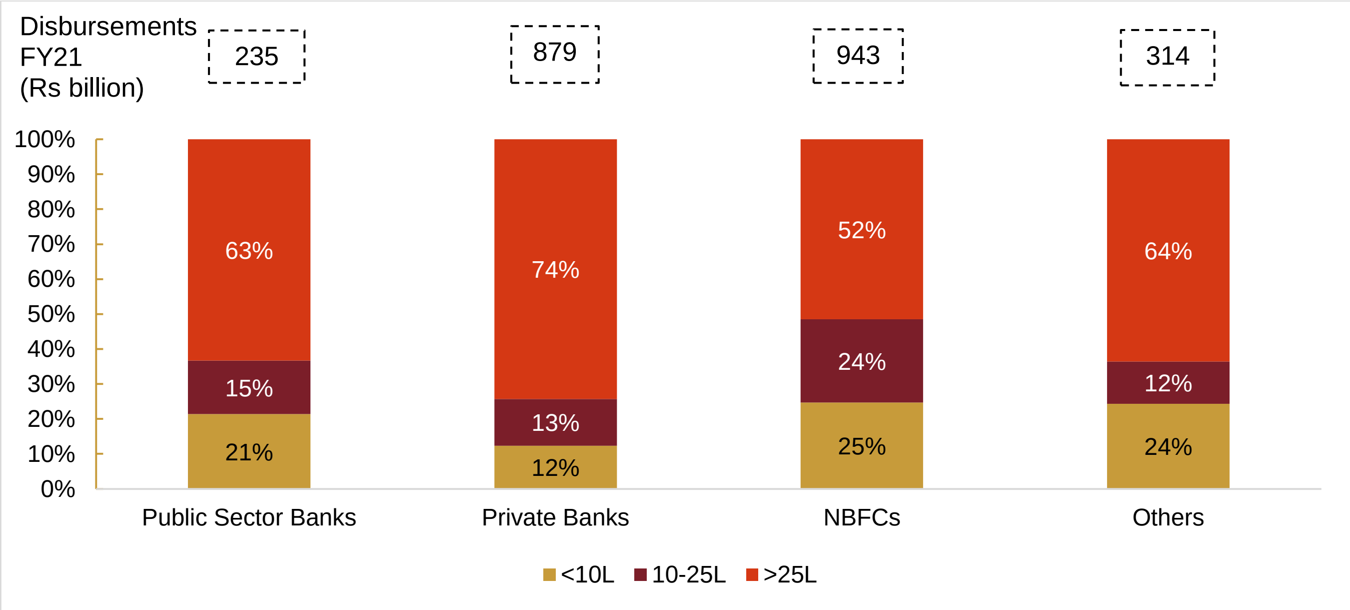


Note: (1) Above data includes business loans given to MSMEs upto Rs 10 lakhs ticket size and reported in consumer bureaus of CICs, (2) Others includes player groups like Small Finance Banks, Foreign Banks, Regional Rural Banks

Source: CRIF Highmark, CRISIL Research

NBFCs have high share of small business loans disbursed (ticket size less than Rs 10 lakhs) compared to private sector banks and public sector banks in fiscal 2021. These banks lend to more organised and formal customers with proper income documentation and credit profile. In contrast, NBFCs lend to borrowers who may not have documented income proof, and therefore, NBFCs rely greatly on their deep understanding of the target customer segment and ability to assess income and cash flows of the customers through personal discussions or other alternate data for underwriting loans.

NBFCs have highest share of its disbursement towards small business loans

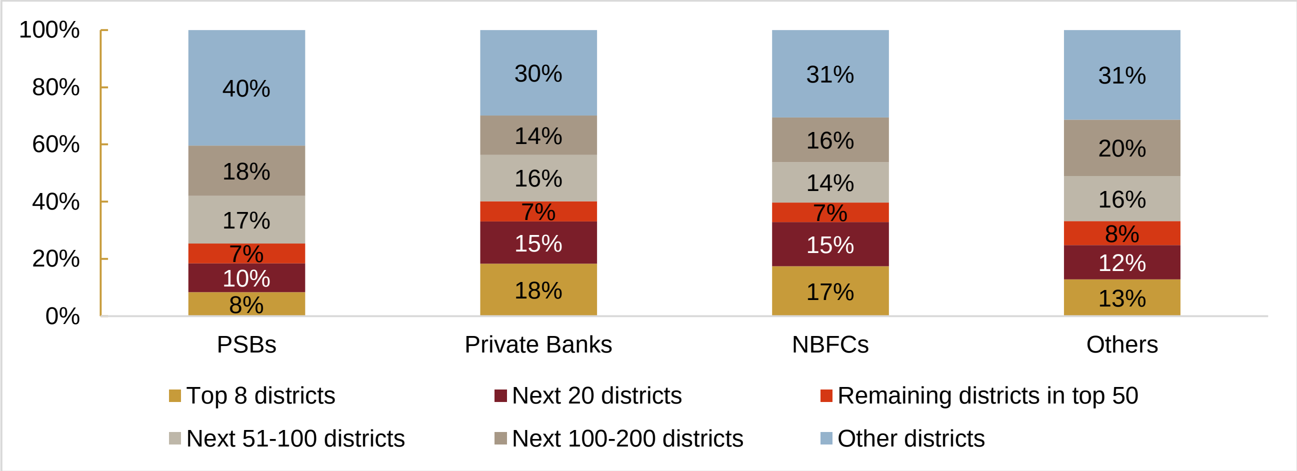


Note: Note: Above data includes business loans reported in consumer bureaus of CICs, Others includes player groups like Small Finance Banks, Foreign Banks, and Regional Rural Banks

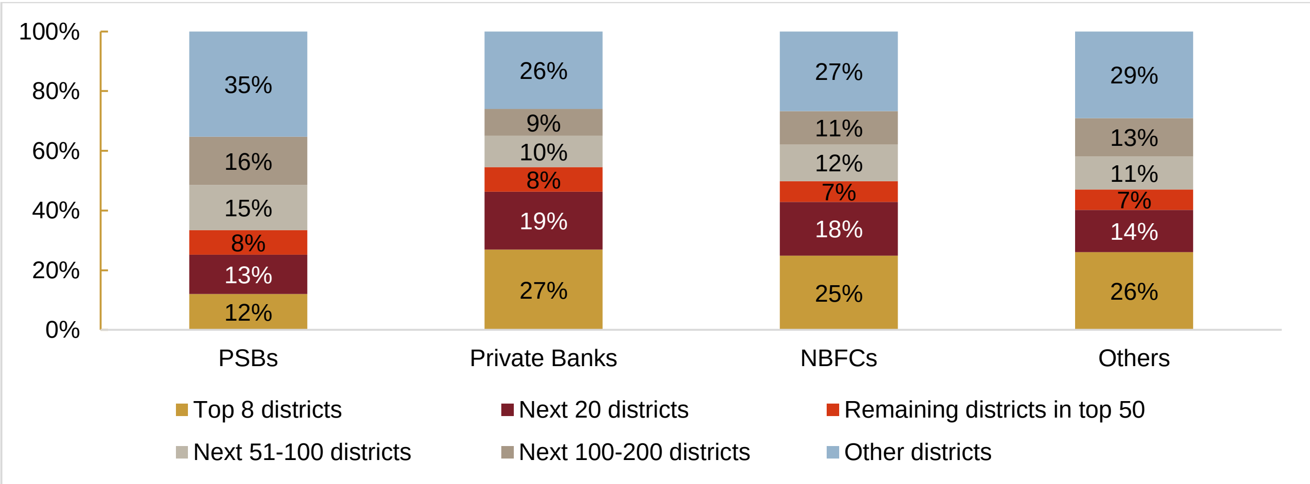
Source: CRISIL Research

Within the small business loans (ticket size less than Rs 10 lakhs), NBFCs have 61% of loan portfolio in cities other than top 50 compared to PSBs and others which have 75% and 66% of their portfolio respectively in such cities. Private banks have the lowest proportion of 60% of small business loans in cities outside the top 50. In other ticket sizes as well, similar trend is observed with PSBs being relatively better penetrated in regions outside top 50 cities compared to NBFCs and private banks being the least penetrated in such regions.

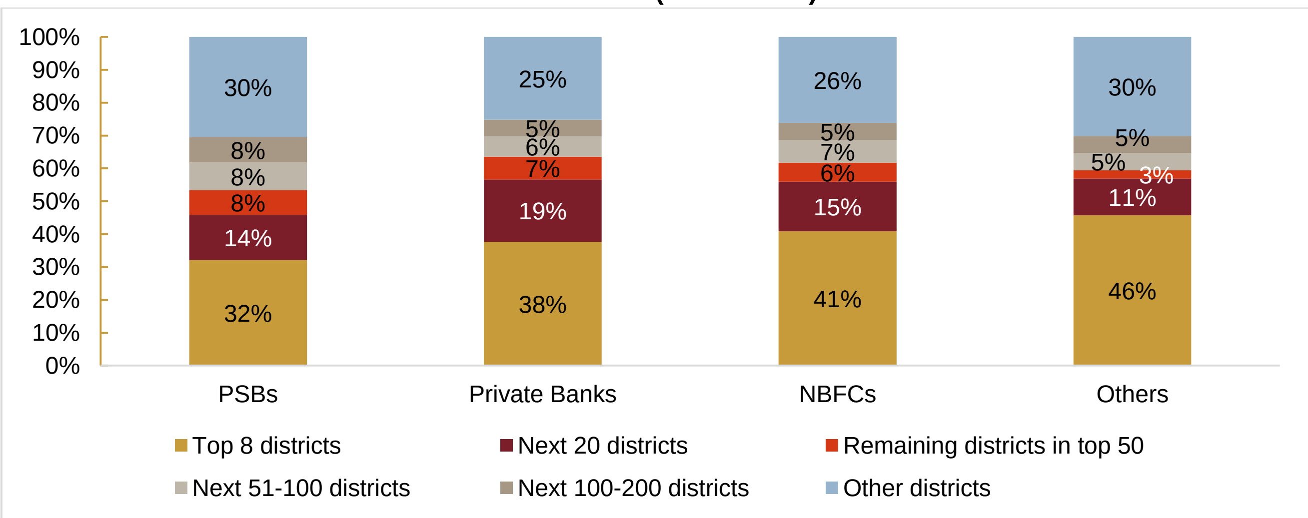
Business loans of ticket size less than Rs 10 lakhs (March 2021)



Business loans of ticket size between Rs 10-25 lakhs (March 2021)



Business loans of ticket size more than Rs 25 lakhs (March 2021)



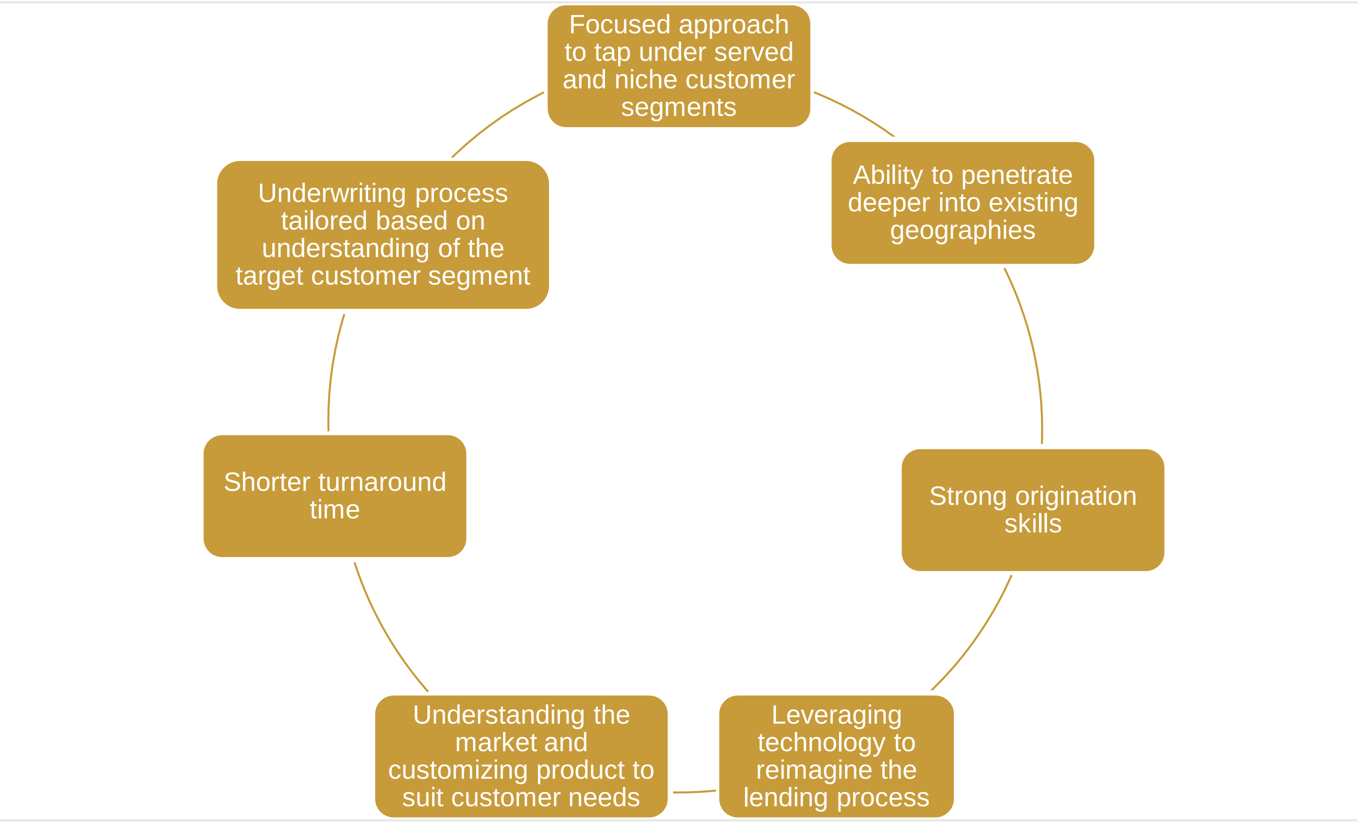
Note: (1) Above data includes business loans given to MSMEs and reported in consumer bureaus of CICs
(2) Others includes player groups like Small Finance Banks, Foreign Banks, Regional Rural Banks
(3)Classification of districts is done based on population as per Census 2011.
(4) Mumbai Metropolitan Region (MMR), National Capital Region (NCR), Bengaluru and Kanpur have each been considered as a district.
(5) MMR includes Thane and Mumbai, NCR includes Delhi, Gurugram, Gautam Buddha Nagar, Ghaziabad and Faridabad, Bengaluru includes Bangalore Urban and Bangalore Rural, Kanpur includes Kanpur Nagar and Kanpur Dehat
Source: CRIF Highmark, CRISIL Research

Key factors driving competitiveness of NBFCs

NBFCs in small business lending have, over the years, developed expertise in serving the underserved and niche customer segments by developing customised products and building strong credit appraisal mechanisms to serve their target segment. Moreover, their ability to penetrate deeper into geographies gives them the edge in serving these customers. Some NBFCs have tailor made underwriting processes customised for the target segment they cater to which gives them an edge in understanding and serving the customers as well as in maintaining their portfolio quality. For example, Five Star Business Finance is among the select institutions to have developed an underwriting model that evaluates the cash-flows of small business owners and self-employed individuals in the absence of traditional documentary proofs of income. NBFCs have also been leveraging technology to efficiently manage the lending process, which has also helped them reduce the turnaround time.

Going forward as well, we expect increasing adoption of technology, increasing credit penetration amongst MSMEs, ability to undertake data analytics across a larger and ever-increasing customer base, and additional data insights driving penetration in categories such as small merchants to drive growth for NBFCs. For example, with growing penetration of digital payments, just this data, when combined with financial statements data and other demographic and firm-specific data, can throw powerful insights on the creditworthiness of customers.

Factors driving growth of NBFCs in small business loans



Source: CRISIL Research

Moreover, compared to different loan products like affordable housing loans, microfinance loans, auto loans and personal loans, secured small business loans is one of the most attractive asset classes offering higher yields over a medium tenure with good collateral quality and lower default risk as the loans are secured predominantly with SORP.

	Market Size – Portfolio outstanding March 2021 (Rs trillion)	Ticket size	Yields	Typical tenure	Collateral Quality	Tendency to default
Secured property-backed small Business Loans	1.7	Small to Medium	High	Medium	Good	Low
Secured non-LAP loans	12	Small to Medium	High	Low	Good	Low
Microfinance loans	3.6	Small	Medium	Low	No collateral	Relatively High
Housing loan	22	Large	Medium	High	Very good	Low
Auto Loans	9.5	Small to Medium	Low to Medium	Low to medium	Moderate	Medium
Personal Loans	1.1	Small	High	Low	No collateral	Medium to High

Source: CRISIL Research

Small business loans market consists of highly heterogeneous players

In absolute terms, the aggregate size of lending in the small business loans segment is estimated to be around Rs 1.7 trillion as of March 2021. There are various kind of players serving this segment including Banks, NBFCs, Small Finance Banks, and Microfinance Institutions that offer loans to self-employed individuals, micro-entrepreneurs as well as MSMEs. While banks offering business loans and loans against property to MSMEs serve a very different customer segment mainly comprising registered MSMEs with documented income and certain annual turnover, other players serve customer segments who may not have appropriate income proofs on paper.

Players across the NBFC spectrum offering business loans can be classified as below:

- Larger NBFCs offering diversified loan products including business loans, both unsecured as well as secured, loans against property and products in other loan segments like commercial vehicles, personal loans, etc. These include larger players like Bajaj Finance, HDB Financial Services, and Hero Fincorp.
- NBFCs offering loans for business purpose, but backed with property (residential property in almost all cases) as collateral. Examples of such NBFCs include Five Star Business Finance, Veritas Finance, and Vistaar Financial Services.
- NBFCs offering collateral-backed loans such as machinery loans for the purpose of funding capex requirements of MSMEs. These include players like Electronica Finance and MAS Financial Services.
- Fintechs, mainly offering unsecured loans to traders and the services segments, on the basis of digital underwriting models based on firm-specific demographic data, bureau scrub, bank statement analysis, GST returns and other behavioural or segment-specific data. For example, Neogrowth Credit, Lending Kart, Capital Float, and Indifi Technologies

- Microfinance players offering loans in rural and underpenetrated areas through joint-liability groups, most of which are towards income-generation activities. Major microfinance players with an NBFC-MFI licence include Credit Access Grameen, Spandana Sphoorty, Satin Creditcare Network, Asirvad Microfinance, and Muthoot Microfinance
- Small Finance Banks with significant portfolio towards MSME loans. These include AU Small Finance Bank, Equitas Small Finance Bank (which offers micro finance as well as small business loans) and Capital Small Finance Bank.

Key Industry Parameters

	Large diversified NBFCs	NBFCs offering secured business loans backed by property as collateral	Fintechs	Microfinance Institutions	Small Finance Banks
Average ticket size	Rs 12 lakhs to 25 lakhs	Rs 3 lakhs to 10 lakhs	Rs 5 lakhs to 10 lakhs	Rs 20,000-Rs 40,000	Rs 5 lakhs to 10 lakhs
Nature of loans	Secured: 50-60%	Secured: 100%	Secured: 0%	Secured: 0%	Secured: (80-90%)
Average interest rate	18-20%	20-25%	24-30%	18-22%	12-18%
Average contractual tenure	36-60 months	60-96 months	18-36 months	12-24 months	12-36 months
Average GNPA (as of March 2021)	2.9%	2.0%	4.3%	3.2%	4.1%
NIMs (FY21)	8.9%	11.8%	11.7%	10.5%	6.9%
Credit cost (FY21)	4.6%	1.4%	7.7%	6.0%	2.2%
Cost to Income Ratio (FY21)	25%	25%	32%	39%	54%
RoA (FY21)	2.1%	5.3%	Negative	0.8%	1.5%
RoE (FY21)	10%	13%	Negative	3%	11.5%
Documentation	Financial Statements, P&L Account, Balance Sheets, Bank Statements	Combination of traditional and non-traditional sources. Use of information available in public and private domains.	ID Proofs, Bank Statements, Proof of business	ID Proofs, Proof of business	Income statements, ID Proof, KYC documents, Bank Statements.

Source: CRISIL Research

The larger NBFCs that have diversified portfolio generally operate at higher ticket sizes and offer both secured and unsecured business loans. Compared to these, NBFCs that have singular focus on small business loans or have significant proportion of small business loans in their portfolio offer customised products for the target segment and operate at ticket sizes of less than Rs 10 lakhs. These NBFCs generally have more focus on underpenetrated areas and customer profiles that may not have easy access to formal credit. This allows players to remain competitive by charging higher risk premium than other lenders operating in higher ticket sizes. Hence, these players generally have yields in the range of 20-25%. There also exists some NBFCs that offer collateral backed business loans in the ticket size band of Rs 10-15 lakhs.

Fintech firms with NBFC licence, MFIs and SFBs are other players that operate in the small business loans landscape. Fintechs leverage data and technology in their business models and are more focussed on unsecured business loans. Hence, they also have higher yields in the range of 24-30% because of the higher risk associated with the customer profile catered and the product segment they operate in. Microfinance Institutions have a regulatory cap on total indebtedness of borrowers and household incomes, hence they operate at very low-ticket sizes in the range of Rs. 30,000 to 40,000.

Comparison of various players based on yield on advances, average ticket size and portfolio type (FY21)

	Yield less than 16%	Yield between 16% and 22%	Yield more than 22%
Average ticket size more than or equal to Rs 10 lakhs	Bajaj Finance Ugro Capital SBFC Finance	Capri Global Poonawala Fincorp Shriram City Union Finance Equitas Small Finance Bank	Neogrowth
Average ticket size between Rs 5 lakhs and Rs 10 lakhs	HDB Financial Services AU Small Finance Bank		Lendingkart Finova Capital Riviera Investors
Average ticket size less than Rs 5 lakhs		CapFloat Financial Services	Veritas Finance Five-Star Business Finance Aye Finance
Average ticket size less than Rs 1 lakhs		Credit Access Grameen Satin Creditcare Network Asirvad Microfinance Muthoot Microfin	Spandana Sphoorty Financial Services

Source: Company Reports, CRISIL Research

Comparison of players based on secured and unsecured loans mix in small business loans

0-10% secured portfolio

1. Neogrowth Credit (6.4%)
2. Lending Kart (2.5%)
3. Riveria Investors (9.1%)
4. CapFloat Financial Services (3.9%)
5. NBFC-MFIs (9.0%)

50-80% secured portfolio

1. HDB Financial Services (4.5%)
2. Ugro Capital (2.7%)

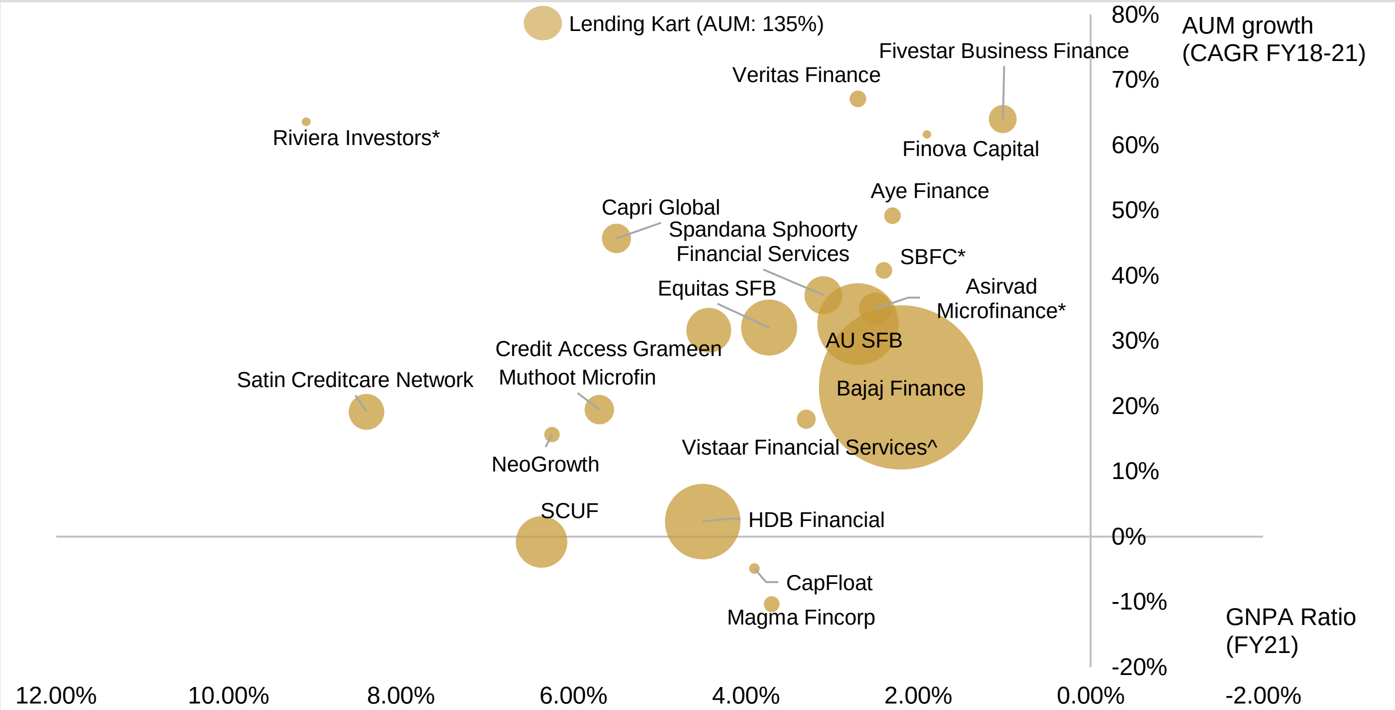
80-100% secured portfolio

1. Shriram City Union Finance (6.4%)
2. Equitas Small Finance Bank (3.3%)
3. AU Small Finance Bank (2.5%)
4. Small Business Fincredit (NA)
5. Finova Capital (1.9%)
6. Veritas Finance (2.7%)
7. Vistaar Financial (3.3%)
8. Five Star Business Finance (1.0%)
9. Capri Global (5.5%)

	0-10% secured portfolio	50-80% secured portfolio	80-100% secured portfolio
GNPA Ratio (FY21)	8-9%	4-5%	3.5-4.5%

Source: Company reports, CRISIL Research

Comparison of various players based on portfolio size, portfolio growth and GNPA ratio (FY21)



Size of the bubble denotes relative size of the small business loan portfolio as of March 2021

Note: (*) GNPA Ratio is as of March 2020, (^) GNPA Ratio is for overall loan book

Source: Company Reports, CRISIL Research

Key success factors for NBFCs offering secured Small Business Loans

Strong branch network and deep understanding of the target customer segment and micro markets

Players need to have a clear and deeper understanding of their target customer segment, the micro markets they operate in and develop a strong local network. The strong network helps players to source business from niche customer category as also obtaining references from their existing customers. It is observed that successful players in the segment generally focus on a few geographies where they have a good understanding and scale up gradually to manage costs and asset quality better. This also helps fine tune their origination and credit underwriting processes over time.

Strong underwriting capabilities along with process standardisation to control operating costs

Customers in small business finance segment are generally self-employed non-professionals (carpenter, plumber, vegetable vendor, small shop keepers, etc.) and micro-entrepreneurs, people who may not have income proofs. Given the lack of income proofs, the underwriting process typically requires detailed personal discussion with the borrower as well as acquaintances and neighbours to assess the source of income and pattern of cash inflows and outflows as well as the stability and behavioural aspects of the customer. In the last few years, some lenders have also started relying on alternate data such as transactions data and digital footprint in order to underwrite customers.

Given the nature of the process, operating costs are typically very high; therefore, players who have strong credit underwriting capabilities, and who are, over a period of time, able to achieve a fair degree of standardisation in the process by building models revolving around specific customer profiles and/or geographies are more likely to be successful.

On-the-ground presence to manage collections and maintain portfolio quality

Additionally, given that players in the segment typically cater to the lower income customer segment, many of whom may not be financially literate, a strong focus on collections and monitoring risk of default at customer level is vital to manage asset quality. There is a need for players to have extensive on-the-ground presence to not only stay connected with their borrowers but also manage collections in a more efficient manner. Players are increasingly using analytical and monitoring tools enabled by technology to better predict default risk.

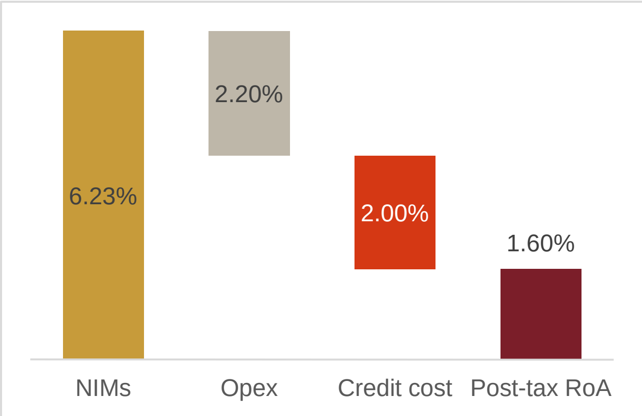
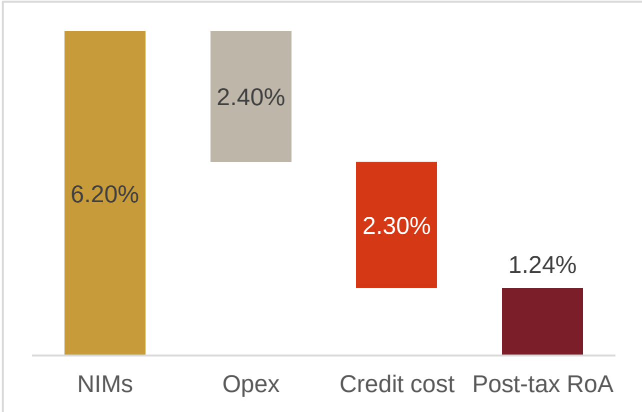
Collateral risk management

Properties that are used as collateral for small business loans sometimes lack proper property titles, especially in the outskirts of large cities, semi-urban and rural areas. With better availability of information and due diligence by the technical team, players can mitigate the risk.

While lenders do take appropriate measures to safeguard against this risk while sanctioning the loan, there have been instances of borrowers mortgaging the same property with multiple lenders. By registering their charge on the underlying property, lenders can protect their interest in respect of the property.

NBFC profitability to take a hit due to higher credit cost

NBFCs in small business loans segment operate with yield in the range of 15-16%, on an average. With cost of funds being in the range of 10-11%, net interest margins (NIMs) for this segment are in the range of 6-7%. CRISIL Research estimates the profitability in this segment to have declined in fiscal 2021 owing to higher credit costs and operational expenses. With cash flows of several MSMEs getting impacted due to the pandemic, the asset quality deteriorated which led to higher credit costs. Operational expenses are expected to have remained relatively higher due to slower business growth and high contribution of DSAs in originating business for NBFCs, especially in unsecured loans.

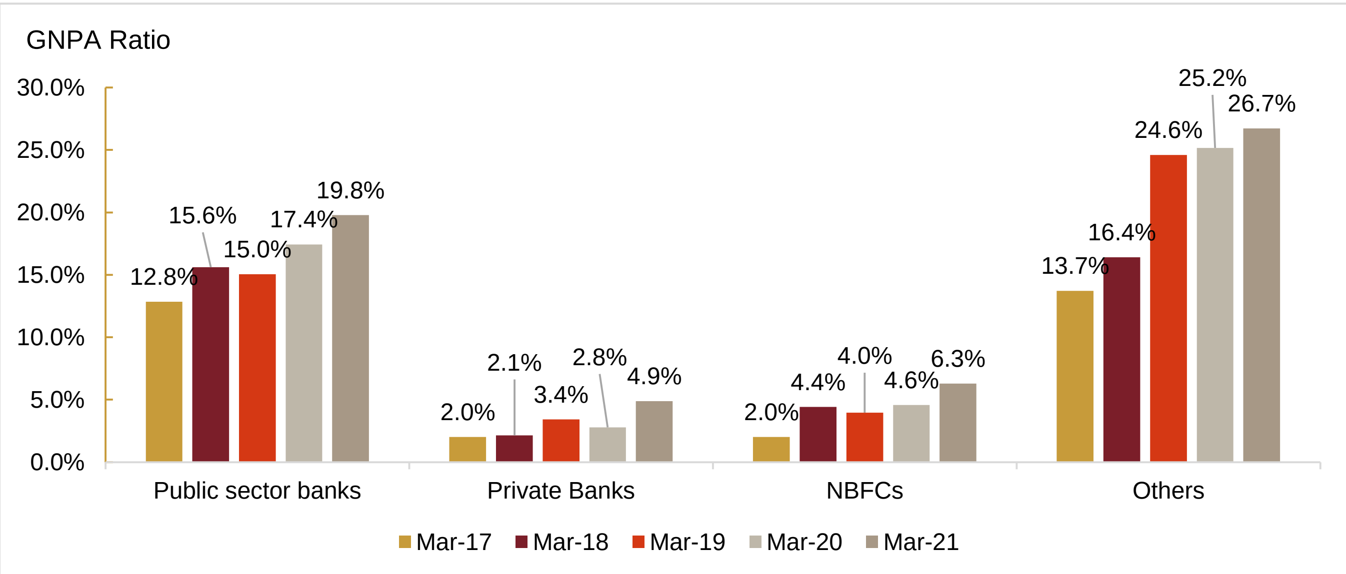
FY20	FY21
	

Source: CRISIL Research estimates

Going forward, in fiscal 2022, an increase in NIMs with borrowing costs going down, a decline in credit cost, and improvement in collections will lead to better profitability.

Over the past few tears, GNPAs for public sector banks and other banks has remained higher than that of NBFCs within the small business loans (ticket size less than Rs 10 lakhs) segment. Public sector banks have the highest GNPA ratio among PSBs, private banks and NBFCs. NBFCs and Private banks have relatively better asset quality in this segment.

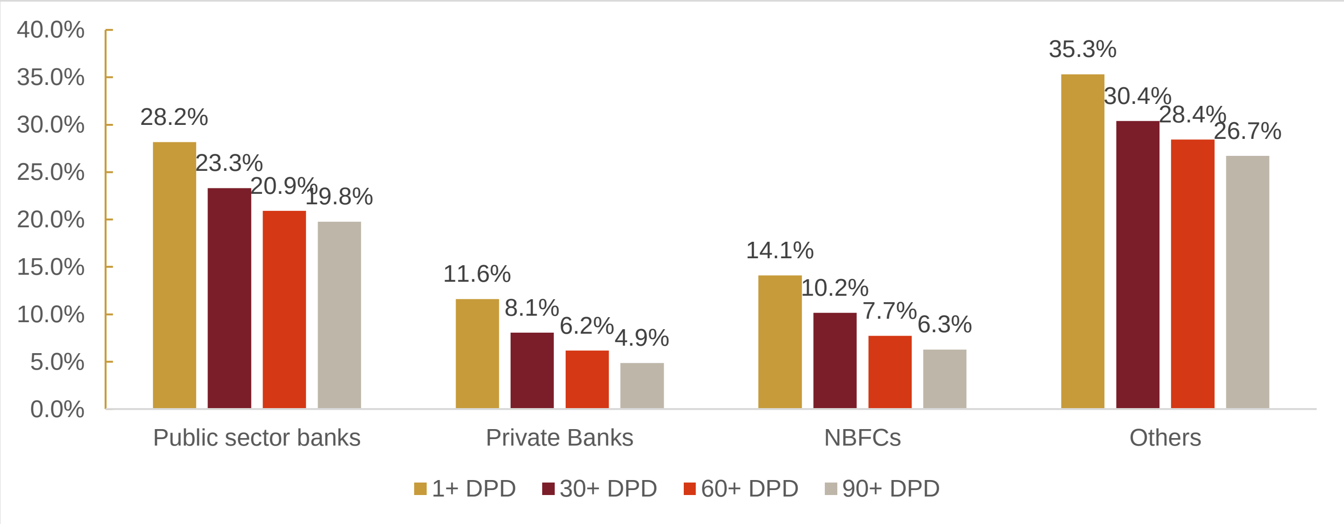
Asset quality across various lenders



Note: Above data includes business loans given to MSMEs upto Rs 10 lakhs ticket size and reported in consumer bureaus of CICs, Others includes player groups like Small Finance Banks, Foreign Banks, Regional Rural Banks

Source: CRIF Highmark, CRISIL Research

DPD bracket wise asset quality for lenders as of fiscal 2021

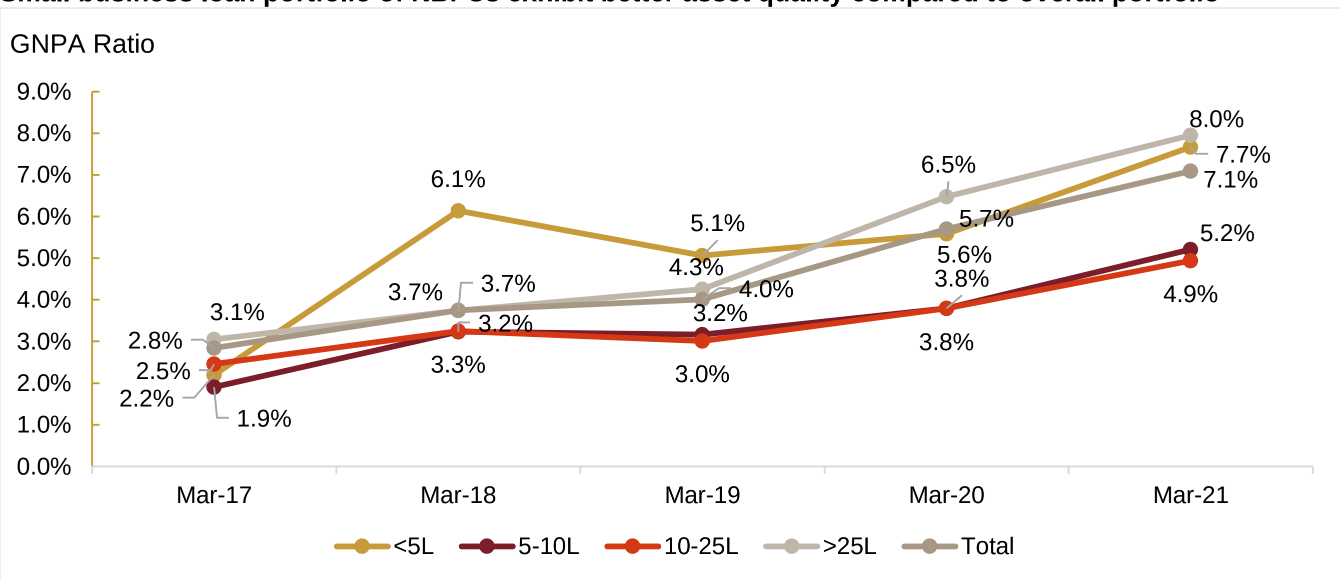


Note: Above data includes business loans given to MSMEs upto Rs 10 lakhs ticket size and reported in consumer bureaus of CICs

Source: CRISIL Research

For NBFCs, as of March 2021, loan portfolio with ticket size more than Rs 25 lakhs has the worst asset quality with GNPA ratio of 8% compared to that of 7.7% and 5.2% and 4.9% for loan portfolio with ticket sizes less than Rs 5 lakhs, between Rs 5 to 10 lakhs and between Rs 10 to 25 lakhs respectively.

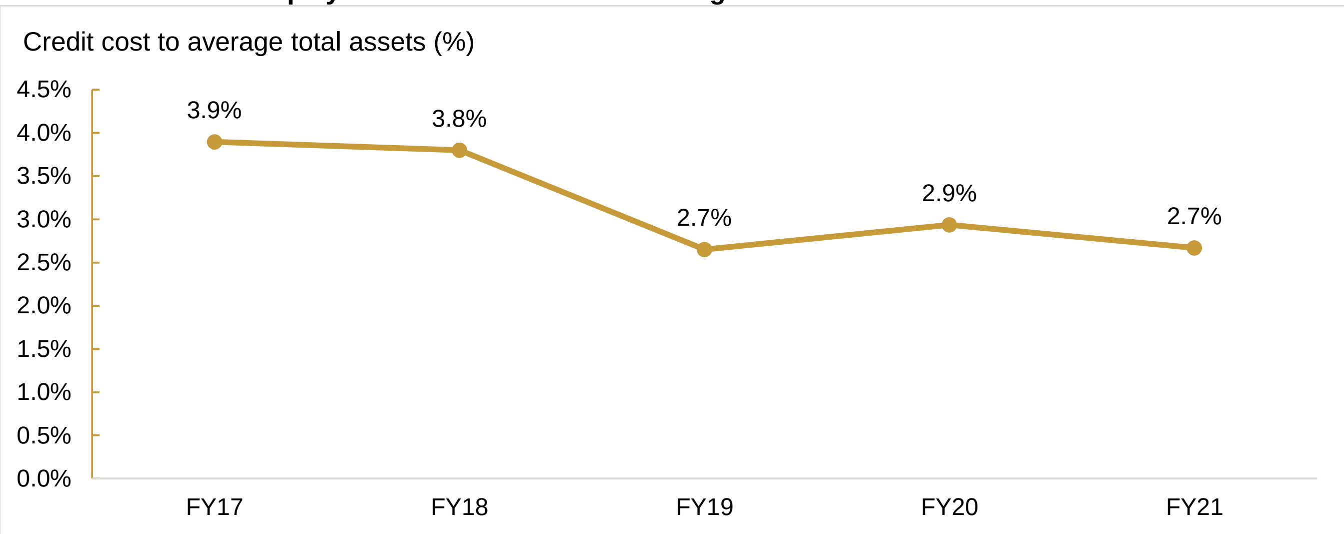
Small business loan portfolio of NBFCs exhibit better asset quality compared to overall portfolio



Note: Above data includes business loans given to MSMEs and reported in consumer bureaus of CICs

Source: CRISIL Research

Trend in credit cost of players in small business loan segment



Note: The above data includes numbers for Five Star Business Finance, Aye Finance, Shriram City Union Finance, Veritas Finance, Vistaar Financial, Lendingkart and Digikredit Finance

Source: Company Reports, CRISIL Research

Player wise credit cost trend

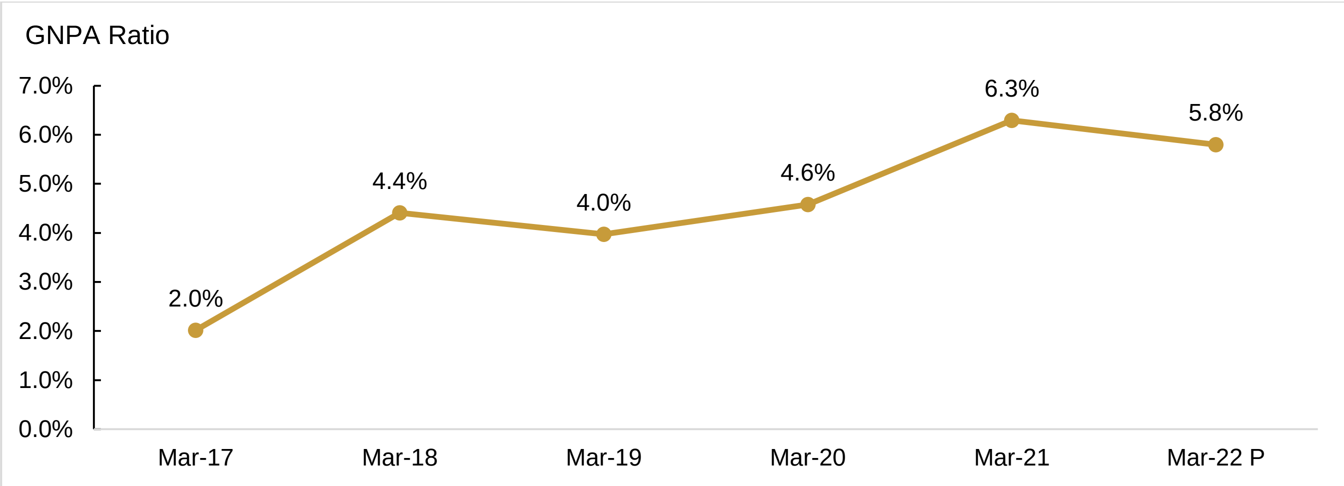
Credit cost as a % of total assets	FY17	FY18	FY19	FY20	FY21
Five Star Business Finance	0.6%	1.0%	0.4%	1.5%	0.7%
Aye Finance	0.8%	1.7%	2.7%	4.0%	2.7%
Shriram City Union Finance	4.0%	3.9%	2.8%	2.9%	2.6%
Veritas Finance	1.4%	1.1%	0.6%	1.0%	2.0%
Vistaar Financial	2.9%	3.2%	3.0%	3.0%	2.7%
Lendingkart	3.7%	6.4%	4.4%	5.7%	6.9%
Digikredit Finance	NA	NA	0.7%	5.0%	10.9%

Source: Company Reports, CRISIL Research

Asset quality for NBFCs to moderate in fiscal 2022

GNPAs in small business loans below Rs 10 lakhs for NBFCs has remained in the range of 4-4.5% for two years ending March 2019 after increasing post demonetisation in fiscal 2018. Asset quality deteriorated in fiscal 2020 and 2021 owing to impact on customers due to the covid-19 pandemic and GNPA ratio increased by 170 basis points to reach 6.3% compared to that as of March 2020 (4.6%). The deterioration in asset quality would have been worse, if it had not been for the support provided by the emergency credit line scheme of the government and restructuring of loans allowed by the RBI. While some portion of the portfolio has got restructured, GNPA has still increased in fiscal 2021.

GNPA levels to moderate in fiscal 2022



Note: Above data includes business loans given to MSMEs upto Rs 10 lakhs ticket size and reported in consumer bureaus of CICs, P-Projected

Source: CRISIL Research

The collection efficiency[3] across various types of small business loans financiers amongst the NBFC universe indicates that while collections have picked up after the moratorium period ended in August 2020, they are still below pre-pandemic levels. For example, NBFCs offering loans for business purpose with property as collateral reported collection efficiency in the range of 90-92% in the third quarter of fiscal 2021 and 94-96% in the fourth quarter of the fiscal. Fintechs, largely offering unsecured loans, saw their collection efficiency move in the range of 86-89% and 90-92% as of the third and fourth quarter of fiscal 2021, respectively. In fiscal 2022, collection efficiencies for players were impacted in the months of April and May 2021 due to localised lockdowns in various states, but subsequently, in June and July 2021, collection efficiency have improved for NBFCs.

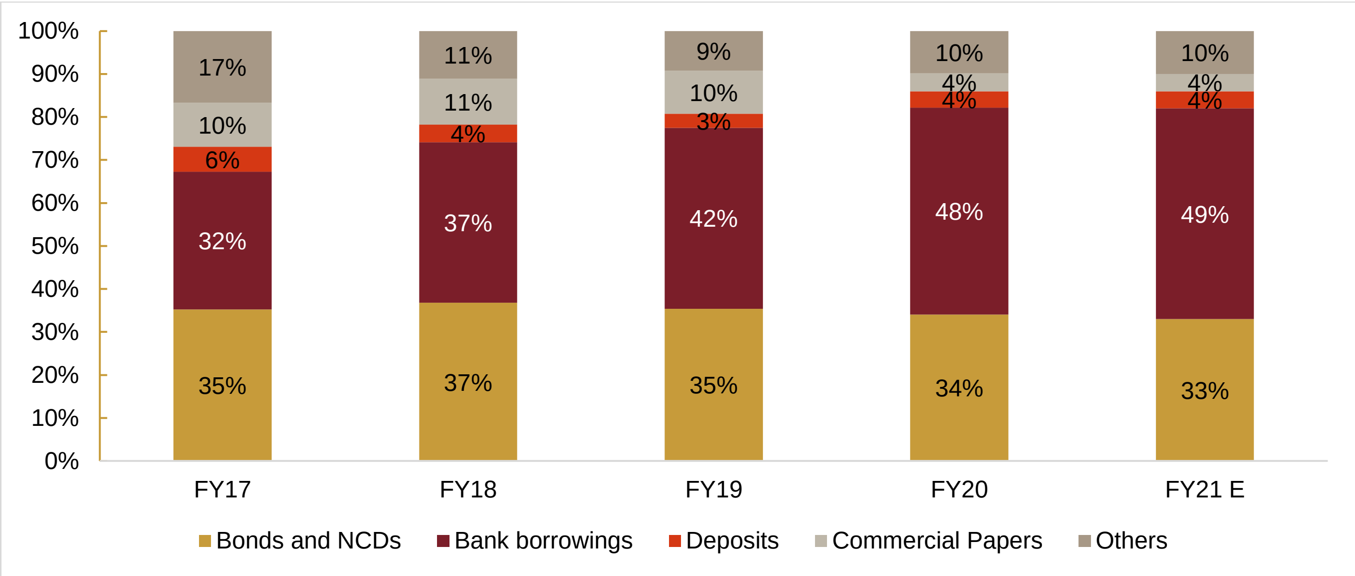
Going forward, GNPAs are expected to moderate but still remain higher than that in last few years on account of slippages. While GDP growth is expected to recover, cash flows for MSMEs is unlikely to spring back to fiscal 2020 levels.

Dependence on bank borrowings to remain high for NBFCs

The resources mix of NBFC's providing small business loans has been changing over the past years due to rising cautiousness of capital market investors in investing in smaller NBFCs and those without parent support. This has resulted in reduction in share of Commercial Papers (CPs) and non-convertible debentures (NCDs) and a corresponding increase in banks borrowings during fiscal 2020. CRISIL Research expects that dependence on bank borrowings will remain high due to limited access to market borrowings for smaller players.

Bank borrowings continue to gain market share in the borrowing mix of NBFCs focused on small business loans

[3] *Monthly collection efficiency is calculated as the proportion of actual collections (from billings for the month and overdues but excluding prepayments) during the month to scheduled billings during the month (assuming no moratorium).*



Note: The above liability profile is based on data for 17 players accounting for 55-60% of portfolio in NBFC Small Business lending
Source: Company Reports, CRISIL Research

Peer benchmarking

Five Star Business Finance is focused on providing secured business loans to micro entrepreneurs and self-employed individuals who are largely ignored by the formal financial system. In this section, we have compared Five Star Business Finance Limited (Five Star) with other NBFCs and HFCs as also small finance banks (SFBs) focused on serving the target segment served by Five Star i.e. self-employed entrepreneurs running small businesses and operating in a similar ticket size band. The peer comparison has been done on the basis of the latest available data for fiscal 2021.

In our assessment, we have considered NBFCs present in secured small business loans, namely Shriram City Union Finance (SCUF), Vistaar Financial Services Private Limited (Vistaar), and Veritas Finance Private Limited (Veritas). AU Small Finance Bank (AUSFB) that provides secured small business loans has also been included in our assessment. In addition, mortgage loan providers targeting a similar customer profile as Five-Star – Aavas Financiers Ltd (Aavas), Aptus Value Housing Finance India Limited (Aptus) and Home First Finance Company India Limited (Home First) have been included in our peer list. Besides, we have considered players providing unsecured small business loan such as Lendingkart Technologies Private Limited (Lendingkart), Digikredit Finance Private Limited (Digikredit) and Aye Finance Private Limited (Aye Finance). For purposes of the discussion below, lenders engaged in extending MSME business loans include Shriram City Union Finance, Five Star Business Finance, Lendingkart, Vistaar, Veritas, Aye Finance and Digikredit,

Five Star one of the fastest growing NBFC among the compared peers

Five Star recorded the third fastest AUM growth of 86% CAGR over fiscal 2016-21 among the compared peers. Over fiscal 2017-21 as well, Five Star recorded the third fastest AUM growth of 73%. Five Star reported 2nd fastest disbursement growth of 107% CAGR over fiscal 2016-2020, next only to Veritas Finance (241%). In terms of absolute size of portfolio, AUSFB, SCUF and Five-Star are the largest players in small business loans segment.

AUM (Rs billion)	FY16	FY17	FY18	FY19	FY20	FY21	CAGR (FY16-21)	CAGR (FY17-21)
AU SFB^	NA	38	59	79	113	144	39%*	39%
SCUF^	105	127	155	177	166	151	8%	4%
Aavas	17	27	41	59	78	95	41%	37%
Five Star	2	5	10	21	39	44	86%	73%
Home First	5	8	14	24	36	41	50%	49%
Aptus	5	8	14	22	32	41	50%	48%
Lending kart	0.5	2	4	14	24	25	119%	98%
Vistaar	8	11	13	14	19	21	20%	16%
Veritas	0.1	1	3	7	13	16	203%	103%
Aye Finance	NA	2	5	10	18	16	58%*	58%
Digikredit	NA	NA	0	2	4	5	193%**	193%**

Note: (^) Data pertains to small business loans and MSME portfolio, (*) CAGR for FY17-21, (**) CAGR for FY18-21
NA - Not available;

Source: Company reports, Rating reports, CRISIL Research

Disbursement (Rs billion)	FY16	FY17	FY18	FY19	FY20	FY21	CAGR (FY16-20)
AU SFB^	NA	20	30	37	49	47	34%**
SCUF^	82	91	103	104	73	32	-3%
Aavas	11	14	21	27	29	27	29%
Five Star	1	4	15	15	24	12	107%
Home First	3	4	7	16	16	11	56%
Aptus	3	4	8	11	13	13	50%
Lendingkart	NA	NA	NA	17	24	NA	NM
Vistaar	6	7	7	8	9	6	11%
Veritas	0.1	1	3	6	8	6	241%
Aye Finance	NA	NA	5	10	16	NA	82%*
Digikredit	NA	NA	NA	NA	NA	NA	NM

Note: (^) Data pertains to small business loans and MSME portfolio, (**) CAGR for FY17-20 (*) CAGR for FY18-20

NA - Not available; NM: Not meaningful.

Source: Company reports, Rating reports, CRISIL Research

Rs billion	% share of Secured Portfolio	AUM		Disbursement	
		FY20	FY21	FY20	FY21
AU SFB*	100%	113	144	48.7	46.6
SCUF*	88%	166	151	73	32
Aavas	100%	78	95	29	27
Five Star	**100%**	39	44	**24**	**12**
Home First	100%	36	41	16	11
Aptus	100%	32	41	13	13
Lendingkart	0%	24	25	24	NA
Vistaar	100%	19	21	9	6
Veritas	100%	13	16	8	6
Aye Finance	0%	18	16	16	NA
Digikredit	14%	4	5	NA	NA

Notes: Players are arranged in descending order of AUM

**AUM and disbursement data for MSME/Small business loan segment; ^Estimated based on advances growth*

NA - Not available; NM: Not meaningful.

Source: Company reports, Rating reports, CRISIL Research

Operational efficiency

Five Star AUM per branch has increased to Rs 170 million in fiscal 2021 from Rs 122 milion in fiscal 2019; Five Star has one of the largest branch networks amongst non-banks

Five Star reported the fastest growth of 68% annual growth in number of employees over fiscal 2016 and 2021 followed by Aavas Financiers (52%). Five Star also recorded the fourth highest AUM per employee and disbursement per employee on an average between fiscals 2019 and 2021.

Five Star reported 3rd fastest growth in terms of branch count over fiscal 2016-21 after Veritas and Aavas FInanciers. With 262 branches as of March 2021, Five-Star has one of the largest branch networks amongst the non-bank universe, next only to SCUF and Aavas amongst the peer set. Despite increasing the number of branches, its AUM per branch has increased by 18% CAGR to Rs 170 million over fiscal 2019-21. While its AUM per branch is lower as compared to lenders focused on mortgage loans, they are higher as compared to other lenders focused on MSME financing who have a branch-focused business model (by around 1.5-2.0 times). This is also reflected its cost-to-income ratio which is much lower than other MSME focused lenders. Fintech lenders in the unsecured MSME loans space operate with minimal branch infrastructure on the ground and hence do not have relatable branch productivity matrices, but their cost-to-income ratios also are higher compared to Five Star.

The branch productivity has also to be viewed in the context of the segment and ticket sizes in which a company operates. Five Star's average ticket sizes, at around Rs 2,59,000 in fiscal 2021, is the lowest compared to other players considered in the peer set.

Trend in average ticket sizes for players

Average ticket size	FY17	FY18	FY19	FY20	FY21
AU SFB	NA	NA	NA	10.5	6.7
SCUF	NA	NA	10	12.5	12.5
Aavas	8.6	8.6	8.6	8.4	8.5
Five Star	NA	3.75	3.37	3.14	2.59
Home First	9.6	10.5	10.3	10.1	10
Aptus	7.5	8.25	7.4	7.2	7
Lendingkart	5	7	6	5	6
Vistaar	NA	NA	NA	NA	5*
Veritas	NA	NA	2.5	3.5	3.5
Aye Finance	NA	NA	NA	NA	NA
Digikredit	NA	NA	7.2	NA	NA

Source: Company reports. Rating reports, CRISIL Research

Trend in number of branches for players

Branches	FY16	FY17	FY18	FY19	FY20	FY21	CAGR (FY16-21)
AU SFB	291	301	377	558	647	744	21%
SCUF	976	998	969	969	909	926	-1%
Aavas	44	94	165	210	250	280	45%
Five Star	73	103	130	173	252	262	29%

Home First	NA	NA	45	60	68	72	17%*
Aptus	70	80	115	142	175	190	22%
Lendingkart	NA	NA	NA	NA	NA	NA	NM
Vistaar	198	201	225	220	216	191	-1%
Veritas	15	38	72	147	202	204	69%
Aye Finance	NA	NA	72	104	173	211	43%*
Digikredit	NA	NA	NA	15	25	18	10%^

Note: (*) CAGR for FY18-21, (^) CAGR for FY19-21

NA - Not available; NM – Not meaningful

Source: Company reports, Rating reports, CRISIL Research

Trend in number of employees for players

Employees	FY16	FY17	FY18	FY19	FY20	FY21	CAGR (FY16-21)
AU SFB	5,072	8,515	11,151	12,623	17,112	22,484	35%
SCUF	25,472	26,783	28,665	27,267	28,699	24,963	0%
Aavas	704	940	1,862	3,190	4,581	5,679	52%
Five Star	293	691	1,290	1,971	3,734	3,938	68%
Home First	175	200	382	675	696	687	31%
Aptus	NA	NA	1,000	1,300	1,702	1,913	24%*
Lendingkart	NA	NA	NA	NA	NA	NA	NM
Vistaar	2,125	2,337	2,107	2,188	1,847	1,660	-5%
Veritas	NA	NA	719	1,422	1,850	2,333	48%*
Aye Finance	NA	NA	1,085	1,887	3,162	NA	71%^
Digikredit	NA	NA	NA	NA	NA	NA	NM

Note: (*) CAGR for FY18-21, (^) CAGR for FY18-20

NA - Not available; NM – Not meaningful

Source: Company reports, Rating reports, CRISIL Research

	AUM per branch (Rs million)				Disbursement per branch (Rs million)			
	FY19	FY20	FY21	Average (FY19-21)	FY19	FY20	FY21	Average (FY19-21)
AU SFB*	154	174	193	174	66	75	63	68
SCUF*	160	183	183	176	107	108	79	98
Aavas	283	312	338	311	127	117	95	113
Five Star	**122**	**154**	**170**	**149**	**86**	**96**	**48**	**76**
Home First	407	532	575	505	262	238	152	217
Aptus	158	182	214	185	77	73	68	73
Lendingkart	NA	NA	NA	NM	NA	NA	NA	NM
Vistaar	66	87	108	87	34	42	30	36
Veritas	51	64	77	64	38	42	30	37
Aye Finance	101	103	74	92	96	94	NA	95@
Digikredit	132	153	253	179	NA	NA	NA	NM

Note: (*) Data pertains to small business loans and MSME portfolio, @Average for FY19-20;

NA - Not available; NM - Not meaningful

Source: Company reports, CRISIL Research

	AUM per employee (Rs million)				Disbursement per employee (Rs million)			
	FY19	FY20	FY21	Average (FY19-21)	FY19	FY20	FY21	Average (FY19-21)
AU SFB^	6.8	6.6	6.4	6.6	2.9	2.8	2.1	2.6
SCUF^	5.4	6.5	5.8	5.9	3.6	3.8	2.5	3.3
Aavas	18.6	17.0	16.6	17.4	8.4	6.4	4.7	6.5
Five Star	**10.7**	**10.4**	**11.3**	**10.8**	**7.5**	**6.5**	**3.2**	**5.7**
Home First	36.2	52.0	60.3	49.5	23.3	23.2	16.0	20.8
Aptus	17.2	18.7	21.3	19.1	8.4	7.5	6.8	7.5
Lendingkart	NA	NA	NA	NM	NA	NA	NA	NM
Vistaar	6.6	10.2	12.4	9.7	3.5	4.9	3.5	4.0
Veritas	5.2	7.0	6.7	6.3	3.9	4.5	2.6	3.7
Aye Finance	5.5	5.6	NA	5.6*	5.3	5.1	NA	5.2*
Digikredit	NA	NA	NA	NM	NA	NA	NA	NM

*Note: (^) Data pertains to small business loans and MSME portfolio, *Average for FY19-20; NA - Not available; NM - Not meaningful*

Source: Company reports, CRISIL Research

	Cost to income ratio				Opex (%)			
	FY19	FY20	FY21	Average (FY19-21)	FY19	FY20	FY21	Average (FY19-21)
AU SFB	92.8%	65.6%	50.2%	69.5%	4.4%	3.9%	3.5%	4.0%
SCUF	40.5%	43.3%	38.3%	40.7%	5.3%	5.0%	4.2%	4.8%
Aavas	47.8%	49.5%	48.1%	48.4%	3.9%	3.5%	3.1%	3.5%
Five Star	**34.9%**	**33.6%**	**31.3%**	33.3%	**6.1%**	**5.1%**	**4.2%**	**5.2%**
Home First	59.9%	49.0%	41.7%	50.2%	3.8%	3.4%	2.6%	3.3%
Aptus	31.5%	27.1%	23.2%	27.3%	3.6%	2.9%	2.4%	2.9%
Lendingkart	79.9%	67.6%	NA	73.8%*	8.6%	8.6%	NA	8.6%*
Vistaar	61.0%	57.0%	47.6%	55.2%	8.8%	7.5%	5.2%	7.2%
Veritas	78.5%	70.9%	55.0%	68.1%	8.8%	7.6%	5.8%	7.4%
Aye Finance	70.9%	64.5%	72.4%	69.3%	9.9%	10.1%	9.0%	9.7%
Digikredit	349.1%	357.0%	246.9%	317.7%	41.5%	29.7%	21.4%	30.9%

**Average for FY19-20; NA - Not available; NM - Not meaningful*

Source: Company reports, CRISIL Research

Product mix

Five Star has been focusing on providing secured loans to micro-entrepreneurs and self-employed individuals.

FY21	Business loans and MSME Finance	Vehicle/Auto Loans	Home loans	LAP	Gold loans	Large and mid-corporate loans	Others
AU SFB	41%	37%	4%	-	-	9%	10%
SCUF	51%	25%	-	1%	13%	-	10%

Aavas	-	-	74%	-	-	-	26%
Five Star	**63%**	**-**	**-**	**-**	**-**	**-**	**37%**
Home First	-	-	97%	-	-	-	3%
Aptus	26%	-	52%	22%	-	-	-
Lendingkart	100%	-	-	-	-	-	-
Vistaar	98%	-	-	-	-	-	2%
Veritas	96%*	-	-	-	-	-	4%
Aye Finance	100%	-	-	-	-	-	-
Digikredit	86%	-	-	14%	-	-	-

*Note: *Includes construction finance loans, Others for Five star are for asset creation and other end uses of the customers*
Source: Company reports, CRISIL Research

Five Star average ticket size is the lowest among the compared peers

FY21	Average ticket size (Rs)	Average LTV	Share of Self-employed	Share of New to credit	No. of states and UTs present in
AU SFB	6,70,000	NA	62%**	25%**	17
SCUF	12,50,000	NA	100%	NA	15
Aavas	8,49,000	55%	65%	NA	11
Five Star	**2,59,000**	**~45%**	**100%**	**30%**	**9**
Home First	10,50,000	70%	27%	31%	11
Aptus	6,20,000	39%	72%	40%	4
Lendingkart	6,00,000	NM	100%	NA	33
Vistaar	5,00,000*	45%	100%	NA	14
Veritas	3,50,000	50%^	99.9%	NA	9
Aye Finance	NA	NA	100%	NA	18
Digikredit	7,20,000	NA	100%	NA	3

(*) Minimum ticket size; (^) Maximum ticket size; (**) For overall portfolio, NA - Not available; NM: Not meaningful
Source: Company reports, CRISIL Research

Most players tend to have geographically concentrated portfolios

It is observed that all players in the considered peer set have a significant portion of their portfolio (between 33-53%) emanating from the largest state in their respective portfolios. This is because strong understanding of the regional dynamics, local market connect and understanding of customer psyche and behaviour are extremely critical to succeed in the customer segment these players cater to. Therefore, players prefer to start slow and mine deeper in various geographies only once they have a reasonable degree of comfort with the regional dynamics and observed data on customer behaviour.

Five Star is a South-based player with the top 4 southern states accounting for 95% of AUM as of March 2021. The company has, however, started spreading its portfolio to other states including Maharashtra, Madhya Pradesh, Chandigarh and Uttar Pradesh.

Statewise distribution of AUM

FY21	Share of top state	Name of top 5 states
AU SFB	40.0%	Rajasthan (40%), Madhya Pradesh (17%), Maharashtra (13%), Gujarat (10%) and Delhi (8%)
SCUF	NA	NA
Aavas*	33.9%	Rajasthan (34%), Maharashtra (16%), Madhya Pradesh (14%), Gujarat (14%) and Uttar Pradesh (8%)
Five Star	**41.0%**	**Tamil Nadu (41%), Andhra Pradesh (28%), Telangana (18%), Karnataka (7%) and Others (5%)**
Home First	38.2%	Gujarat (38%), Maharashtra (19%), Tamil Nadu (11%), Karnataka (9%) and Rajasthan (6%)
Aptus	52.3%	Tamil Nadu (52%), Andhra Pradesh (27%), Karnataka (10%) and Telangana (10%)
Lendingkart	15%^	NA
Vistaar	36.0%	Tamil Nadu (36%), Karnataka (14%), Maharashtra (13%), Madhya Pradesh (10%) and Gujarat (10%)
Veritas	45.0%	Tamil Nadu (45%), West Bengal (23%), Karnataka (8%), Telangana (8%) and Odisha (6%)
Aye Finance	NA	NA
Digikredit	NA	NA

Figures in the bracket after each state relate to the share of the state in the AUM of the respective company
**Based on distribution of branches; ^Less than 15%; NA – Not available*
Source: Company reports, CRISIL Research

Profitability

Five Star has the highest NIMs amongst compared peers

Among the compared peers, Five Star has the highest NIMs (average of 15.1%) over fiscal 2019-21, which can be attributed to the strong yields it has been able to charge as a result of specific focus on the target segment. Five Star has the second highest yield on advances of 24.3% over fiscal 2019-21, next only to Aye Finance. Five Star's opex as a proportion of average assets contracted by 189 bps to 4.2% in fiscal 2021 from 6.1% in fiscal 2019 due to higher operating leverage. The extent of opex reduction, in the case of Five Star, was higher than any of its peers in the MSME financing business, with the exception of Veritas. Entities involved in mortgage loans had a lower opex to average assets ratio.

Five Star the highest RoA amongst the compared peers over fiscal 2019-21

Five Star posted the highest RoA between fiscal 2019 and 2021, with its average RoA over this time period being 7.9%. Despite the pandemic in fiscal 2021, the company has posted a strong RoA of 7.1%, and the next best was Aptus with 6.5% in fiscal 2021. Five Star also has the second best RoE of 16.8% after AU SFB in fiscal 2021. Five star witnessed highest growth in PAT over fiscal 2016 and 2021.

In terms of net profit margin as well, Five Star has the second highest net profit margin of 34% in fiscal 2021 after Aptus Value Housing Finance (41%). Among the players engaged in extending MSME business loans, Five Star tops the list with highest net profit margin in fiscal 2021 as well as highest average net profit margin between fiscal 2019 and 2021.

	Yield on advances (%)				NIMs (%)			
	FY19	**FY20**	**FY21**	**Average (FY19-21)**	**FY19**	**FY20**	**FY21**	**Average (FY19-21)**
AU SFB	15.0%#	15.5%#	15.1%^	15.2%	3.0%	2.9%	2.9%	2.9%
SCUF	21.1%	20.9%	20.1%	20.7%	12.7%	11.4%	10.1%	11.4%
Aavas	13.9%	13.5%	13.1%	13.5%	6.3%	5.7%	5.3%	5.8%
Five Star	**24.3%**	**24.2%**	**24.3%**	**24.3%**	**17.2%**	**14.9%**	**13.2%**	**15.1%**
Home First	12.8%	13.3%	12.7%	13.0%	4.7%	5.0%	4.6%	4.8%
Aptus	17.2%	17.6%	17.1%	17.3%	10.3%	9.3%	9.7%	9.8%
Lendingkart	23.1%	24.7%	NA	23.9%*	10.1%	11.7%	NA	10.9%*
Vistaar	21.6%	20.7%	19.2%	20.5%	14.0%	12.0%	9.9%	12.0%
Veritas	22.1%	24.9%	23.4%	23.5%	10.2%	9.9%	10.2%	10.1%
Aye Finance	25.0%	28.5%	27.3%	26.9%	12.0%	15.0%	11.9%	13.0%
Digikredit	21.3%	26.1%	21.8%	23.1%	5.1%	6.0%	6.4%	5.8%

**Average for FY19-20; ^Book yield for MSME/Small business loan (SBL) segment; # Disbursement yield for MSME/SBLsegment*
NA - Not available.
Source: Company reports, CRISIL Research

Cost of funds (%)	FY19	FY20	FY21	Average (FY19-21)
AU SFB	7.4%	7.4%	6.5%	7.1%
SCUF	11.0%	11.4%	11.0%	11.1%
Aavas	8.0%	7.9%	7.8%	7.9%
Five Star	**10.1%**	**13.1%**	**11.2%**	**11.5%**
Home First	10.3%	9.4%	7.9%	9.2%
Aptus	9.5%	10.2%	9.1%	9.6%
Lendingkart	11.5%	13.5%	NA	12.5%*
Vistaar	11.0%	10.8%	10.2%	10.7%
Veritas	9.0%	13.2%	10.7%	11.0%
Aye Finance	12.2%	13.1%	14.1%	13.1%
Digikredit	17.9%	18.5%	12.7%	16.3%

**Average for FY19-20; NA - Not available; NM – Not meaningful*
Source: Company reports, CRISIL Research

PAT (Rs million)	**FY16**	**FY17**	**FY18**	**FY19**	**FY20**	**FY21**	**CAGR (FY16-21)**
AU SFB	2,110	8,220	2,920	3,820	6,750	11,710	41%
SCUF	5,300	5,560	7,109	9,889	10,005	10,109	14%

Aavas	321	579	931	1,759	2,491	2,895	55%
Five Star	137	196	534	1,567	2,620	3,590	92%
Home First	60	88	252	422	796	1,001	76%
Aptus	175	372	667	1,117	2,110	2,669	72%
Lendingkart	(37)	(141)	(523)	(39)	(216)	(285)	NM
Vistaar	249	334	326	337	450	648	21%
Veritas	(19)	(28)	61	205	333	620	59%*
Aye Finance	(41)	(72)	23	251	325	169	49%*
Digikredit	NA	NA	(48)	(149)	(392)	(491)	NM

*Note: *CAGR for FY18-21; NA - Not available; NM – Not meaningful*

Source: Company reports, CRISIL Research

Net profit margin	FY19	FY20	FY21	Average (FY19-21)
AU SFB	11%	14%	18%	14%
SCUF	17%	17%	17%	17%
Aavas	25%	28%	26%	26%
Five Star	38%	33%	34%	35%
Home First	16%	19%	20%	18%
Aptus	33%	40%	41%	38%
Lendingkart	-2%	-5%	-6%	-4%
Vistaar	11%	12%	16%	13%
Veritas	15%	12%	17%	15%
Aye Finance	12%	8%	4%	8%
Digikredit	-66%	-83%	-86%	-78%

Source: Company reports, CRISIL Research

	RoA (%)				RoE (%)			
	FY19	FY20	FY21	Average (FY19-21)	FY19	FY20	FY21	Average (FY19-21)
AU SFB	1.6%	1.9%	1.3%*	1.6%	14.0%	17.9%	12%*	14.6%
SCUF	3.5%	3.3%	3.1%	3.3%	16.6%	14.7%	13.2%	14.8%
Aavas	3.6%	3.8%	3.5%	3.6%	11.6%	12.7%	12.9%	12.4%
Five Star	**8.9%**	**7.8%**	**7.1%**	**7.9%**	**16.0%**	**15.8%**	**16.8%**	**16.2%**
Home First	2.2%	2.7%	2.5%	2.5%	9.8%	10.9%	8.7%	9.8%
Aptus	5.9%	7.0%	6.5%	6.4%	17.4%	17.5%	14.5%	16.5%
Lendingkart	-0.3%	-1.0%	-1.1%	-0.8%	-1.1%	-3.2%	-3.5%	-2.6%
Vistaar	2.3%	2.5%	3.0%	2.6%	5.8%	7.3%	9.6%	7.6%
Veritas	2.7%	2.3%	3.1%	2.7%	6.7%	5.3%	7.3%	6.4%
Aye Finance	2.8%	2.0%	0.8%	1.9%	8.6%	6.4%	2.7%	5.9%
Digikredit	-16.9%	-18.9%	-17.9%	-17.9%	-42.6%	-41.2%	-46.3%	-43.4%

*Note: * In calculation of RoA and RoE, PAT excludes profit on sale of Aavas stake for AU SFB. Inclusing it, the RoA is 2.5% and RoE is 23.4%*

Return on assets (RoA) computed above is defined as profit after tax for the year divided by the average of the opening and closing total assets for the year as reported in the annual reports / public disclosures for these companies. The information contained in this table may deviate from the methodology that individual companies (including Five Star) may use to calculate Return on assets and as such, investors are advised to read that data together with the corresponding definition used for computing the Return on assets therein

Source: Company reports, CRISIL Research

Five Star has the third best asset quality among the compared peers; best asset quality amongst MSME focused lenders

Among the compared peers, Five Star is among the three best in terms Gross NPA ratio for fiscal 2021. It also has the best asset quality amongst lenders engaged in extending MSME business loans with GNPA ratio of 1.02% in fiscal 2021 compared to other lenders reporting 90+ dpd in excess of 2%. It also has the second lowest credit cost of 1.5% in fiscal 2020 and lowest credit cost of 0.7% in fiscal 2021 among the compared peers engaged in extending MSME loans in fiscal 2021, given its asset quality.

GNPA	FY16	FY17	FY18	FY19	FY20	FY21	Average(FY16-21)
AU SFB	0.88%	1.90%	2.00%	2.00%	1.90%	2.50%	1.86%
SCUF	5.15%	6.20%	9.41%	8.91%	7.90%	6.37%	7.32%
Aavas	0.48%	0.63%	0.34%	0.47%	0.46%	0.98%	0.56%
Five Star	NA	2.50%	1.80%	0.87%	1.37%	1.02%	1.51%*
Home First	0.39%	0.69%	0.59%	0.8%	1.0%	1.80%	0.88%
Aptus	0.41%	0.45%	0.50%	0.40%	0.70%	0.68%	0.52%
Lendingkart	0.43%	3.78%	2.11%	1.30%	2.18%	2.47%	2.05%
Vistaar	2%	3%	3.95%	3.39%	3.67%	3.25%	3.15%
Veritas	0.00%	0.97%	0.74%	0.90%	1.86%	2.70%	1.20%
Aye Finance	0.20%	0.90%	1.54%	1.70%	2.30%	2.86%	1.58%
Digikredit	NA	NA	NA	0.62%	0.98%	2.53%	1.38%^

Note: (*) Average for FY17-21, (^) Average for FY19-21

Source: Company reports, CRISIL Research

NNPA (%)	FY19	FY20	FY21	Average (FY19-21)
AU SFB	1.30%	0.80%	2.20%	1.43%
SCUF	5.02%	4.23%	3.08%	4.11%
Aavas	0.37%	0.34%	0.71%	0.47%
Five Star	**0.67%**	**1.13%**	**0.84%**	**0.88%**
Home First	0.57%	0.77%	1.20%	0.85%
Aptus	0.33%	0.61%	0.49%	0.48%
Lendingkart	0.57%	0.97%	0.90%	0.81%
Vistaar	2.64%	2.50%	2.22%	2.45%
Veritas	0.76%	1.28%	1.37%	1.14%
Aye Finance	0.42%	NA	NA	NM
Digikredit	0.39%	0.67%	0.95%	0.67%

**December 2020; NA - Not available; NM – Not meaningful*
Source: Company reports, CRISIL Research

	Credit cost (%)[@]	Covid provision - credit cost (%)	Stage 3 provisi ons to	Total provisi ons to	Total provis ion to	Restru ctured book (%)

							Stage 3 assets	Stage 3 assets	AUM ratio	
	FY19	FY20	FY21	Average (FY19-21)	FY20	FY21	FY21	FY21	FY21	FY21
AU SFB^	0.6%	0.8%	1.5%	1.0%	0.4%	0.3%	49.8%	62%	**2.5%**	**1.8%**
SCUF^	2.8%	2.9%	2.6%	2.8%	1.4%	0.9%	53.2%	109%	6.9%	1.0%
Aavas	0.2%	0.2%	0.4%	0.3%	0.2%	0.1%	28.3%	69%	0.5%	0.0%
Five Star	**0.4%**	**1.5%**	**0.7%**	**0.9%**	**0.8%**	**0.5%**	**17.9%**	**192%**	**1.9%**	**0.0%**
Home First	0.2%	0.6%	0.8%	0.5%	0.2%	NA	36.0%	74%	1.1%	0.0%
Aptus	0.1%	0.1%	0.1%	0.1%	NA	NA	28.1%	52%	0.3%	0.0%
Lendingkart	4.4%	5.7%	6.9%	5.1%*	NA	2.6%	64.1%	312%	6.6%	20.0%
Vistaar	3.0%	3.0%	2.7%	2.9%	NA	2.1%	32.9%	114%	3.5%	7.0%
Veritas	0.6%	1.0%	2.0%	1.2%	NA	NA	50.0%	91%	2.5%	0.2%
Aye Finance	2.7%	4.0%	2.7%	3.1%	NA	NA	NA	NA	NA	6.0%
Digikredit	0.7%	5.0%	10.9%	5.5%	NA	NA	43.7%	59%	0.7%	4.9%

*Note: (^) Data pertains to overall portfolio, *Average for FY19-20; @Credit cost includes Covid -19 provision; NA - Not available.*

Source: Company reports, CRISIL Research

Five Star has the second highest Capital Adequacy ratio amongst the compared peers as of March 2021

Five Star has the second highest CRAR of 58.9% after Aptus among the compared peers as of March 2021. It also has the lower leverage as compared to any of its peers which indicates better ability to leverage further leading to better RoEs.

	Leverage (times)				Capital adequacy ratio (%)			
	FY19	FY20	FY21	Average (FY19-21)	FY19	FY20	FY21	Average (FY19-21)
AU SFB	8.86	8.34	6.85	8.02	19.3%	22.0%	23.4%	21.6%
SCUF	3.43	3.18	3.15	3.25	22.9%	27.7%	28.6%	26.4%
Aavas	1.99	2.55	2.64	2.39	46.7%	54.4%	55.9%	52.3%
Five Star	**0.70**	**1.22**	**1.48**	**1.13**	**64.8%**	**52.9%**	**58.9%**	**58.9%**
Home First	3.06	2.67	2.21	2.65	38.0%	49.0%	56.2%	47.7%
Aptus	2.29	1.18	1.27	1.58	43.6%	82.5%	73.6%	66.6%
Lendingkart	1.84	2.01	1.92	1.92	39.0%	36.2%	38.7%	38.0%
Vistaar	1.52	2.04	2.10	1.89	40.3%	37.6%	36.5%	38.1%
Veritas	1.34	1.23	1.41	1.33	48.0%	59.3%	50.7%	52.7%
Aye Finance	1.52	2.69	1.78	2.00	44.3%	31.0%	39.0%	38.1%
Digikredit	0.96	0.84	2.18	1.33	38.3%	59.2%	27.9%	41.8%

Note: For AU SFB, numbers also include the impact of CASA. For HFCs, the risk weights are lower than that for other NBFCs catering to business loans segment.

Source: Company reports, CRISIL Research

Long-term credit rating for various players*

Players	Long-term Credit Rating
AU SFB	CRISIL AA-, ICRA AA-, CARE AA-, IND AA-
SCUF	CRISIL AA, ICRA AA, CARE AA, IND AA
Aavas	ICRA AA-, CARE AA-
Five Star	ICRA A+, CARE A+
Home First	ICRA A+, CARE A+
Aptus	ICRA A+, CARE A+
Lendingkart	ICRA BBB+
Vistaar	ICRA A-, IND A-
Veritas	CARE A-
Aye Finance	ICRA BBB+, IND A-
Digikredit	CRISIL BBB

**Ratings outstanding across credit ratings agencies as of September 2021.*

Source: Company reports, Rating reports, CRISIL Research

Borrowing mix

FY21	Debt Securities	From banks	From NBFC	Financial institutions	External commercial borrowings (ECB)	Borrowings under securitisation arrangement	from other parties
AU SFB	-	5%	-	95%	-	-	-
SCUF	21%	49%	13%	-	-	17%	-
Aavas	25%	73%	-	1%	-	-	1%
Five Star	**38%**	**29%**	**9%**	**-**	**-**	**25%**	**-**
Home First	8%	55%	-	36%	-	-	1%
Aptus	17%	54%	-	23%	-	6%	-
Lendingkart*	29%	34%	-	-	-	15%	23%
Vistaar	12%	54%	-	19%	15%	-	-
Veritas	42%	42%	-	-	-	-	15%
Aye Finance*	62%	8%	-	9%	3%	18%	-
Digikredit	88%	12%	-	-	-	-	-

**FY20 data*
Source: Company reports, CRISIL Research

Five Star has second highest surplus in ALM in after 12 months bucket among the compared NBFCs

Amongst the NBFC peer set analysed, Five Star has the second highest ALM surplus (Rs 24.8 billion) after Aptus in after 12 months bucket. AU SFB has the highest ALM surplus of Rs 124.9 billion after 12 months among the compared peers.

ALM position of various peers

FY21 (Rs billion)	Assets		Liability		Net	
	Within 12 months	After 12 months	Within 12 months	After 12 months	Within 12 months	After 12 months

AU SFB	169.4	739.0	246.0	614.1	-76.6	124.9
SCUF	257.9	171.4	140.7	154.3	117.2	17.2
Aavas	23.6	63.0	10.0	53.4	13.6	9.6
Five Star	**6.9**	**83.2**	**10.6**	**58.4**	**-3.7**	**24.8**
Home First	13.6	28.7	8.2	22.4	5.4	6.3
Aptus	14.1	71.8	6.9	25.2	7.1	46.6
Lendingkart*	10	34	8	23	1.9	10.5
Vistaar	4	16	5	10	-0.8	5.9
Veritas	5	12	7	6	-1.7	6.7
Aye Finance	9	29	6	22	2.8	7.2
Digikredit	NA	NA	NA	NA	NA	NA

** FY20 data; NA – Not available*
ALM reported in the table above has been sourced by CRISIL Research from annual reports / public disclosures of the companies mentioned herein, including for Five Star. Investors should note that individual companies may compute ALM differently. The information contained in this table may deviate from Five Star's ALM data disclosed elsewhere in the DRHP and as such, investors are advised to read that ALM data together with the corresponding definitions used for computing the ALM therein

Source: Company reports, CRISIL Research

List of formulae

Parameters	**Formula**
RoA	Profit after tax / average of total assets on book
RoE	Profit after tax / average net worth
NIM	(Interest income – interest paid) / average of total earning assets on book
Yield on advances	Interest earned on loans and advances / average of total advances on book
Cost to income	Operating expenses / (net interest income + other income)
Cost of funds	Interest paid / (average of deposits and borrowings)
Credit cost	Provisions / average total assets on book
Net Profit Margin	Profit after tax/ total income

About CRISIL

CRISIL is a leading, agile and innovative global analytics company driven by its mission of making markets function better. It is India's foremost provider of ratings, data, research, analytics and solutions, with a strong track record of growth, culture of innovation and global footprint.
It has delivered independent opinions, actionable insights, and efficient solutions to over 100,000 customers.
It is majority owned by S&P Global Inc, a leading provider of transparent and independent ratings, benchmarks, analytics and data to the capital and commodity markets worldwide.

About Research

CRISIL Research is India's largest independent integrated research house. We provide insights, opinion and analysis on the Indian economy, industry, capital markets and companies. We also conduct training programs to financial sector professionals on a wide array of technical issues. We are India's most credible provider of economy and industry research. Our industry research covers 86 sectors and is known for its rich insights and perspectives. Our analysis is supported by inputs from our network of more than 5,000 primary sources, including industry experts, industry associations and trade channels. We play a key role in India's fixed income markets. We are the largest provider of valuation of fixed income securities to the mutual fund, insurance and banking industries in the country. We are also the sole provider of debt and hybrid indices to India's mutual fund and life insurance industries. We pioneered independent equity research in India, and are today the country's largest independent equity research house. Our defining trait is the ability to convert information and data into expert judgements and forecasts with complete objectivity. We leverage our deep understanding of the macro-economy and our extensive sector coverage to provide unique insights on micro-macro and cross-sectoral linkages. Our talent pool comprises economists, sector experts, company analysts and information management specialists.

Industry Report on Small Business Loans in India

Five-Star Business Finance Limited

September 2022

Table of Contents

Macroeconomic Scenario

World economy fighting inflation surge post Covid-19 with Indian economy facing volatile commodity prices and tightening of liquidity

Fiscal 2020 was volatile for the global economy. The first three quarters were ensnared in trade protectionist policies and disputes among major trading partners, volatile commodity and energy prices, and economic uncertainties arising from United Kingdom's exit from the European Union (Brexit). Hopes of broad-based recovery in the fourth quarter were dashed by the COVID-19 pandemic, which led to considerable human loss and economic disruption.

In CY 2021, global trade performed better with merchandise trade growing 26% y-o-y in value terms in CY 2021. The positive trend was witnessed globally on account of easing of pandemic restrictions, recovery in demand owing to economic stimulus packages (particularly in advanced economies) and increase in commodity prices.

India's merchandise trade recorded growth across both imports and exports in fiscal 2023, with imports growing by 37.2% in the first quarter of FY23. Net exports created a drag on the growth in Q1FY23 with a growth rate of 14.7% on-year. However, going forward, CRISIL expects multiple headwinds as economic recovery continues to gather pace as global growth is projected to slow, with central banks in major economies withdrawing easy monetary policies to tackle high inflation.

According to the latest provisional estimates released by the National Statistical Office (NSO) in May 2022, India's real Gross Domestic Product (GDP) growth has been pegged at 8.7% in fiscal 2022, lower than the last estimate of 8.9% released as second advance estimate in February 2022. In absolute terms, real GDP for fiscal 2022 is estimated at Rs 147.4 trillion, marginally less than Rs 147.7 trillion estimated earlier. The downward revision in GDP reflects a minor correction in first to third quarter GDP numbers, and a mild impact of third wave of Covid-19 and impact of Russia- Ukraine war in the fourth quarter. Further, given the large output loss due to Covid-19 pandemic, the real GDP is only 1.5% above the pre-pandemic level (fiscal 2020).

According to the National Statistical Office estimates released in August 2022, India's real gross domestic product (GDP) grew 13.5% on-year in the first quarter of FY23, a tad lower than CRISIL's expectation of 15.2% and RBI's estimate of 16.2% and 20.1% in the first quarter of FY22. The economy was hit by the pandemic in the first quarter of FY21 and first quarter of FY22. In contrast there was no pandemic induced disruption in the first quarter of FY23 and hence the first quarter data seems to be statistically boosted by the favourable base effect. Despite global issues like Russia-Ukraine war, the growth momentum (in seasonally adjusted terms) improved sequentially during the quarter.

As global growth is projected to slow down due to withdrawal of easy monetary policies by major economies around the world, demand for Indian exports would slow down. With high commodity prices, especially oil, this translates into a negative in terms of a trade shock for India. High commodity prices, aided by depreciating rupee indicates high imported inflation. As most of the international commodity prices have come off their peaks and a weaker global demand could imply that the downward trajectory of commodity prices would continue, they would continue to be high on-year. Firms would continue to pass on high commodity prices to end customers which would increase inflation. Uncertainty due to the Russia-Ukraine war could put private capex plans on the back burner which would imply lower investment growth.

Despite global slow down, there is a silver lining for the Indian economy as well. Recent RBI surveys indicate improving customer sentiments which will be a boost to the consumption demand and the first quarter GDP figures show just that. Rise in capacity utilisation rates in the manufacturing sector is favourable for private capex. This is especially true in case of infrastructure linked sectors (such as steel and cement) and Production Linked Incentive scheme linked sectors. CRISIL also expects the growing momentum in contact-intensive sectors to be broad based. However, that said, slower than expected growth in the first quarter of FY23, increases the downward bias to the real GDP growth. CRISIL retains GDP growth projection of 7.3% for fiscal 2023.

In the near-term, while risks due to the Covid-19 pandemic seem to be waning, high inflation, exacerbated by supply chain challenges because of the Russia-Ukraine war, and consequent tightening of interest rates by Central banks globally pose risks to economic growth globally and in India. According to International Monetary Fund (*World Economic Outlook – July 2022*), global growth prospects have changed markedly since last year. In CY2021, global growth rebounded with a robust growth of 6.1% from -3.1% the previous year, but it is expected to slow in CY2022 to 3.2%, impact of which is expected to be witnessed in Indian economy as well. Further, their exist a downside risk arising from high inflation and the Ukraine war, which could push the world economy to the brink of recession, if unchecked.

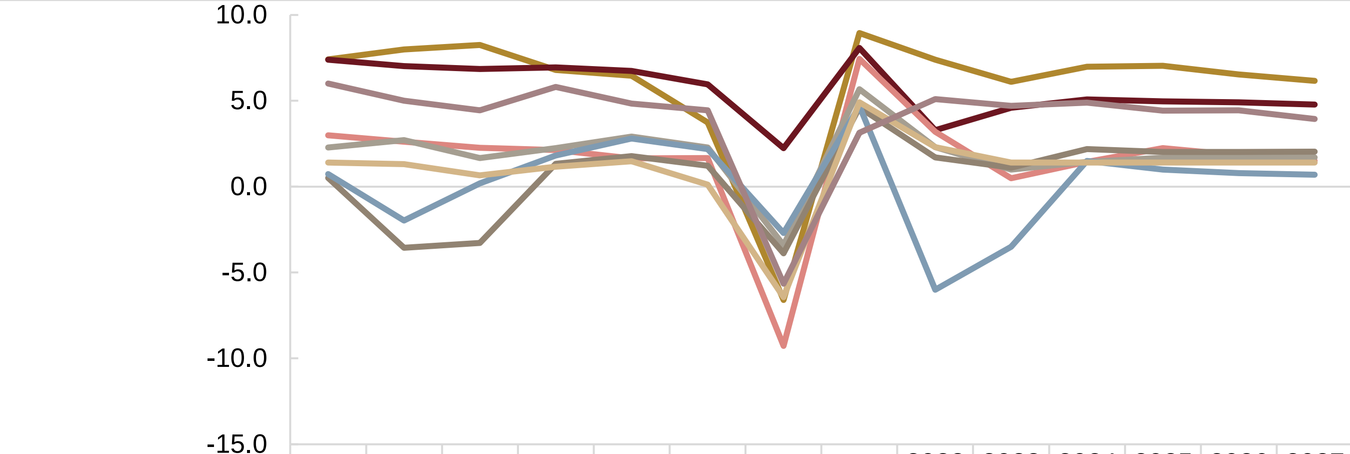
Russia - Ukraine war slowed global recovery; but India expected to remain one of the fastest growing economies

According to IMF, the economic damage from the ongoing war in Ukraine has contributed to a slowdown in global growth and rising inflation causing damage to various countries. The war has caused a humanitarian crisis in Eastern Europe, and various sanctions being imposed on Russia to end hostilities. In addition, frequent and wider-ranging lockdowns in China have slowed activity as it is a major manufacturing hub, which could cause new bottlenecks in the global supply chain. Further, Russia is a major supplier of oil, gases and metals and Ukraine is a major supplier of wheat and corn, and an anticipated decline in the supply of these essential commodities could spike up the prices in the global commodities market.

India was one of the fastest growing economies in the world pre-COVID-19, with annual growth of around 6.7% between calendar years 2014 and 2019. Over the few years prior to the onset of the COVID-19 pandemic, India's macroeconomic situation had gradually improved with the twin deficits (current account and Fiscal) narrowing and the growth-inflation mix improving. The Government adopted an inflation-targeting framework that provided an institutional mechanism for inflation control, while modernising central banking.

CRISIL Research expects growth outlook for FY2023 to be fettered with multiple risks. Nevertheless, India is expected to remain the fastest growing economy in the world with GDP growth of 7.3% projected in fiscal 2023 as per CRISIL Research. The IMF too estimates India's GDP to grow by 7.4% in FY2023 due to its broad range of fiscal, monetary and health responses. However, IMF projects the growth to slow down to 6.1% in FY 2023.

India is one of the fastest-growing major economies (GDP growth, % year-on-year)



	2014	2015	2016	2017	2018	2019	2020	2021	2022 P	2023 P	2024 P	2025 P	2026 P	2027 P
India	7.4	8.0	8.3	6.8	6.5	3.7	-6.6	8.9	7.4	6.1	7.0	7.0	6.5	6.2
China	7.4	7.0	6.9	6.9	6.8	6.0	2.2	8.1	3.3	4.6	5.1	5.0	4.9	4.8
United Kingdom	3.0	2.6	2.3	2.1	1.7	1.7	-9.3	7.4	3.2	0.5	1.5	2.2	1.8	1.5
United States	2.3	2.7	1.7	2.3	2.9	2.3	-3.4	5.7	2.3	1.0	1.4	1.7	1.7	1.7
Brazil	0.5	-3.5	-3.3	1.3	1.8	1.2	-3.9	4.6	1.7	1.1	2.2	2.0	2.0	2.0
Russia	0.7	-2.0	0.2	1.8	2.8	2.2	-2.7	4.7	-6.0	-3.5	1.5	1.0	0.8	0.7
South Africa	1.4	1.3	0.7	1.2	1.5	0.1	-6.4	4.9	2.3	1.4	1.4	1.4	1.4	1.4
Malaysia	6.0	5.0	4.5	5.8	4.8	4.4	-5.6	3.1	5.1	4.7	4.9	4.4	4.4	3.9

Note: All forecasts refer to IMF forecasts. GDP growth is based on constant prices, Data represented is for calendar years, For India, data and forecasts are presented on a fiscal year basis, with FY2021/22 starting in April 2021, hence 2022P numbers for India can be taken as actuals
P: Projected, Source: IMF (World Economic Outlook – July 2022 update)

Indian economy to be a major part of world trade

Along with being one of the fastest growing economy in the world, India ranked fifth in the world in terms of nominal GDP in calendar year 2021. In terms of Purchasing Power Parity (PPP), India is the third largest economy in the world, only after China and the United States.

GDP Ranking of key economies across the world (2021)

Country	GDP Rank	% Share (World GDP)	PPP Rank	% Share (World GDP, PPP)
United States	1	23.8%	2	15.7%
China	2	18.1%	1	18.6%
Japan	3	5.1%	4	3.8%
Germany	4	4.3%	5	3.3%
United Kingdom	5	3.3%	10	2.3%
India	6	3.3%	3	6.9%
France	7	3.0%	11	2.3%
Italy	8	2.1%	13	1.9%
Canada	9	2.0%	16	1.4%
Korea	10	1.9%	14	1.7%
Russia	11	1.8%	6	3.0%

Note: Purchasing Power Parity (PPP) weights are individual countries' share of total World gross domestic product at purchasing power parities. Purchasing Power Parity is a theory which relates changes in the nominal exchange rate between two countries currencies to changes in the countries' price levels, Source: IMF, CRISIL Research

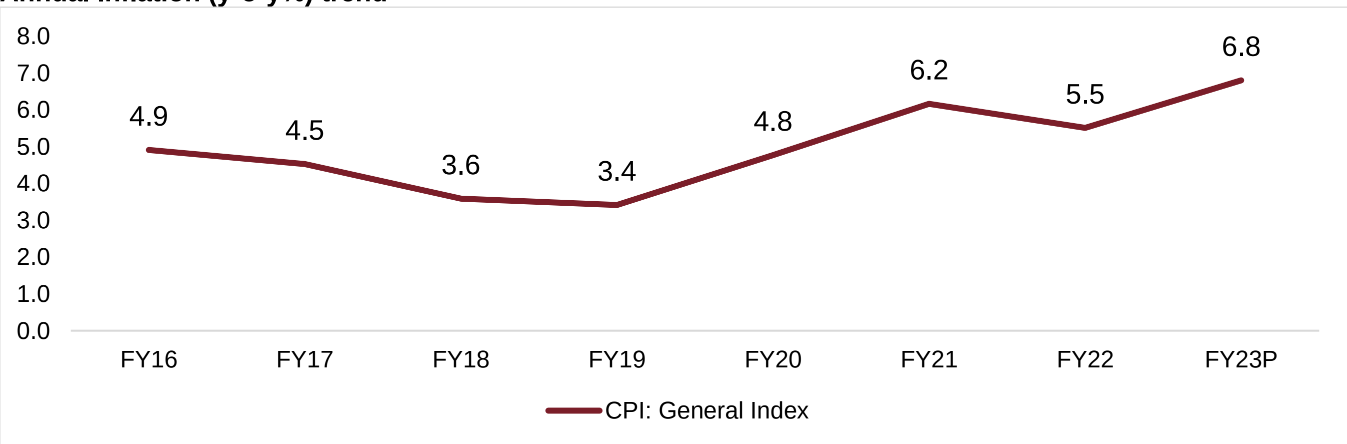
With continuous growth in the GDP, India is expected to become the third largest global economy by 2030, as per the Centre for Economics and Business Research (CEBR). This growth in India's GDP is expected to be driven by rapid urbanisation, rising consumer aspiration and increasing digitalisation coupled with Government support in the form of reforms and policies that are expected to support growth.

CPI inflation to average at 6.8% in fiscal 2023

India remains vulnerable to external shocks, impacting major macroeconomic variables. Inflation based on the Consumer Price Index (CPI), also known as retail inflation, increased to 7.0% on-year in August 2022 from 6.7% previous month. After easing in May and July, inflation has again risen in August due to surging food inflation, especially cereal prices. Fading base effect of last year is also causing the surge in inflation even as non-food inflation moderated slightly in August. Core inflation is expected to remain sticky as producers are expected to pass on the price increases to consumers amid demand recovery. Headline inflation remains above 6% the upper limit of the RBI's target range, for the eighth month in a row.

While inflation peaked at 7.8% in April 2022, inflation was easing since May before rising in August. Inflation eased in July, due to a fall in food and transport fuel inflation which helped ease household inflation expectations as indicated by the RBI's August survey. Rise of CPI inflation in August is due to rising cereal, vegetable and services inflation which has offset the impact of moderating inflation in the past few months. However, some pain points still remain for the Indian economy. Even as the monsoon continues to be normal, sowing is slower on-year for major kharif crops, like rice and arhar. Wheat prices are high due to heatwaves in the months of March-May, which impacted the production of wheat and producers are expected to pass through the costs to consumers to a greater extent amid recovering demand. The RBI's latest survey of manufacturing and services sector indicate firms to increase selling prices in the remainder of the fiscal. CRISIL Research expects Brent Crude to average $105-$110 per barrel in 2023 as compared to $80 per barrel in fiscal 2022. CRISIL expects CPI inflation to average 6.8% in fiscal 2023 compared to 5.5% in the previous year, with risks tilted to the upside.

Annual Inflation (y-o-y%) trend

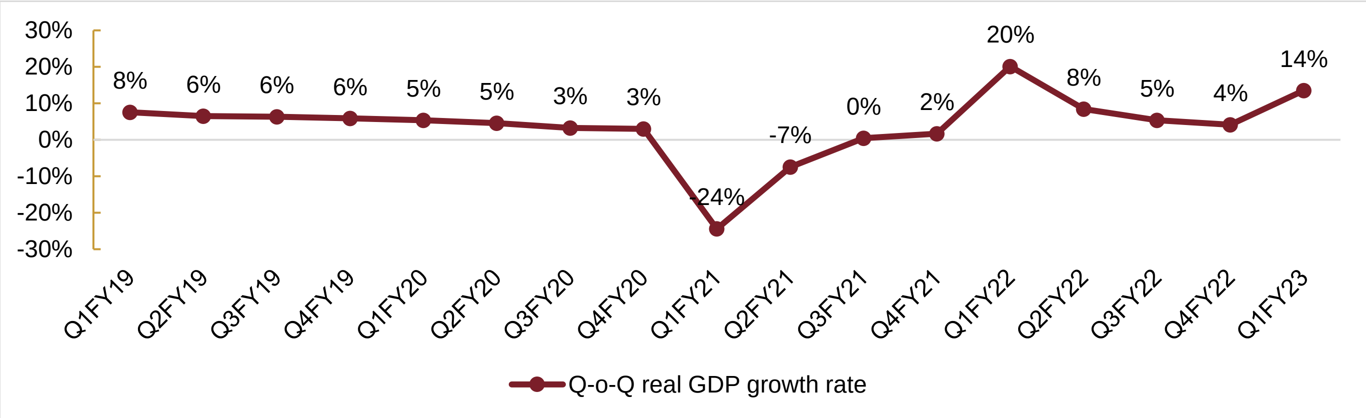


Source: CSO, Ministry of Industry and Commerce, CRISIL Research

Financial conditions begin to tighten with mounting inflation

The Reserve Bank of India's (RBI's) Monetary Policy Committee (MPC) raised policy rates by 40 bps in May 2022. This was followed by another rate hike of 50 bps in June 2022, and another 50 bps in August, thus bringing the repo rate to 5.40%, standing deposit facility (SDF) to 5.15% and marginal standing facility (MSF) to 5.65%. The hike in interest rate was required as inflation, despite some softening was above RBI's limit. Spill over risks from hike in US federal rates and other major central banks is also a factor for the increase in repo rates. Compared with 140 bps hike by RBI in 2022 so far, US Federal Reserve has hiked its policy rate by 225 bps in 2022 so far. MPC expects CPI inflation to remain above 6% in the next two quarters as well

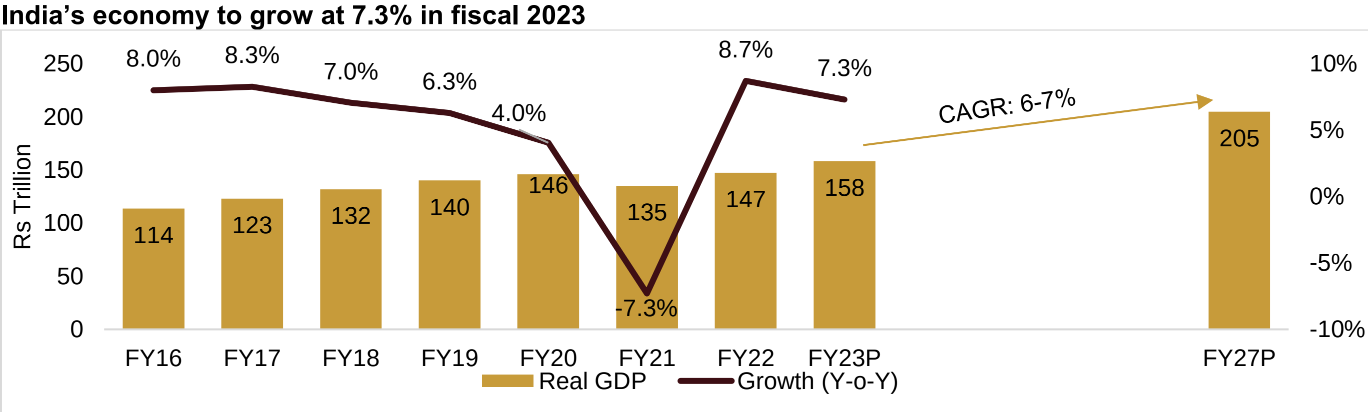
Trend in real GDP growth rate on quarterly basis



Source: CSO, RBI, CRISIL Research

The RBI's policy tightening is also warranted to reduce pressure on rupee from widening current account deficit (CAD) and foreign portfolio investor (FPI) outflows. CRISIL expects CAD to rise to 3% of GDP in the current fiscal (FY23). In addition, the foreign exchange reserves of India have also reduced in the recent months, given RBI's intervention to control rupee's depreciation. Due to these factors, CRISIL expects another 25-bps hike in repo rate this fiscal. Further, because of slowing global growth, persistently high crude prices and rising domestic interest rates, CRISIL now expects India's GDP growth to be 7.3% in fiscal 2023, with risks tilted to the downside.

India's economy to grow at 7.3% in fiscal 2023



Note: FY23 is projected based on CRISIL estimates FY24-FY27 is projected based on IMF estimates
Source: CRISIL Research, IMF World Economic Outlook – July 2022

Macroeconomic outlook for Fiscal 2023

Macro variables	FY22	FY23P	Rationale for outlook
GDP (y-o-y)	8.7*%	7.3%^	Fiscal 2023 growth to be influenced by inflation and external spillovers. Higher oil prices, slowing global demand for India's exports and higher inflation will act negative for the Indian economy. Inflation which reduces purchasing power would weigh in the revival of consumption, the largest component of GDP which has been backsliding for a while. However, a normal monsoon and rebound in contact-intensive services are expected to bring some succor.
Consumer price index (CPI) inflation (y-o-y)	5.5%	6.8%	CPI inflation has been easing since May due to fall in food and fuel inflation before rising in August. However, sowing is lower on-year for major kharif crops. Food prices are expected to remain high this fiscal. Producers are also expected to pass on the costs to consumers to a greater extent amid recovering demand.
10-year Government security yield (fiscal-end)	6.8%	7.5%	Increase in gross market borrowing by the government, rate hikes by the RBI and the US Federal Reserve along with surging crude oil price is expected to cause a surge in G-Sec yields.
CAD (Current account balance)/GDP (%)	-1.2%	-3%	India is expected to be vulnerable to external shocks raising current account deficit. Major factors will be elevated commodity prices, slowing global growth and supply chain snarls.
Rs/$ (March average)	76.2	78	The rupee-dollar exchange rate will remain volatile with a depreciation bias in the near term due to widening trade deficit, foreign portfolio investment (FPI) outflows and strengthening of the US dollar index. US Dollar index will strengthen due to rate hikes by US Federal Reserve and safe-haven demand for the dollar amid the geopolitical risks.

*Note: *NSO estimate, ^ with downside risk, P – Projected*
Source: Reserve Bank of India (RBI), National Statistics Office (NSO), CRISIL Research

Positive government regulations to aid economic growth

After clawing back in fiscal 2022, CRISIL Research forecasts India's GDP to grow at ~7% per annum between fiscals 2023 and 2025. This growth is expected to be supported by the following factors:

- Focus on investments rather than consumption push enhancing the productive capacity of the economy.
- The production linked incentive (PLI) scheme which aims to incentivise local manufacturing by giving volume-linked incentives to manufacturers in specified sectors
- Raft of reform measures by the government along with a more expansionary stance of monetary policy leading to a steady pick-up in consumption demand
- Policies aimed towards greater formalisation of the economy, which are bound to lead to an acceleration in per capita income growth

Prior to the onset of the pandemic, India's GDP growth slowed on account of existing vulnerabilities such as a weak financial sector and subdued private investment. However, considering production-linked incentive (PLI) scheme, reduction in corporate tax rate, labour law reforms together with healthy demographics and a more favourable corporate tax regime, India is expected to witness stable growth, supported by prudent fiscal and monetary policy.

The focus of Union Budget 2022-23 on pushing capital expenditure (capex) despite walking a fiscal tightrope provides optimism and creates a platform for GDP growth.

A Reserve Bank of India (RBI) study points out that an increase in capex by the central and state governments by one rupee each induces an increase in output by Rs 3.25 and Rs 2.0, respectively *(Source: RBI Bulletin – April 2019).* The lift in the consumption cycle is tied to broad based pick-up in economic activity – which the Indian government is trying to engineer through focus on investments. This is expected to enhance the growth potential of India's economy and, it is hoped, will bring endurance to growth in the medium term. However, refraining from giving a direct consumption support may curb the pace of economy recovery in short term.

Booster vaccinations to protect economy from a major economic impact of any fresh Covid surge

As of September 6th, 2022, India's COVID-19 vaccination coverage has exceeded 2,137 million. In addition, vaccination for children in the age group of 15-18 years was also announced from January 3, 2022, onwards. 52 million children have been administered two doses as of 6th September 2022. Government has also allowed administration of precautionary third dose, with 170 million people being administered precaution/booster dose till 6th September 2022. The large proportion of vaccinated people is expected to aid, sustain and strengthen the economic recovery that was observed in fiscal 2022. This is particularly true for contact-based services, which have been the biggest victims of the COVID-19 pandemic.

As of September 2022, India is seeing decreasing cases. If there is a covid wave in future, CRISIL believes that with the pace of vaccination and booster doses, the impact on the economy will be less severe. However, it will remain a key monitorable, as the pandemic has not yet been officially eradicated.

Risks to growth

Elevated inflation: Even as inflation is easing, as can be seen in July, major headwinds still are there for the Indian economy. Producers are expected to pass on the increase in cost to end customers to a greater extent amid recovering demand.

High Policy Rates for Major Economies: Increase in the interest rates of major economies can lead to a negative impact on Indian Economy. Sharp appreciation of the US Dollar is putting pressure on rupee even as domestic fundamentals remain resilient. A weaking rupee can further add to domestic inflationary pressures through higher cost of imports.

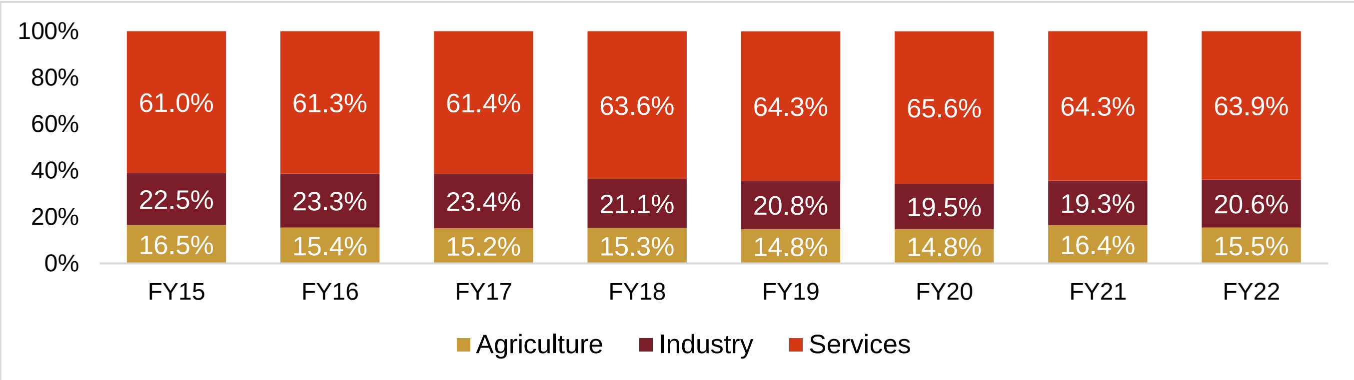
Global Slowdown: Global growth is projected to slow down in fiscal 2023 as central banks tackle inflation with high policy rates. This could imply lower demand for Indian exports.

Uncertainty of Russia-Ukraine war: The conflict could delay private capital expenditure plans of companies as they navigate through the supply-chain restrictions caused by the war.

Contribution of various sectors to GDP

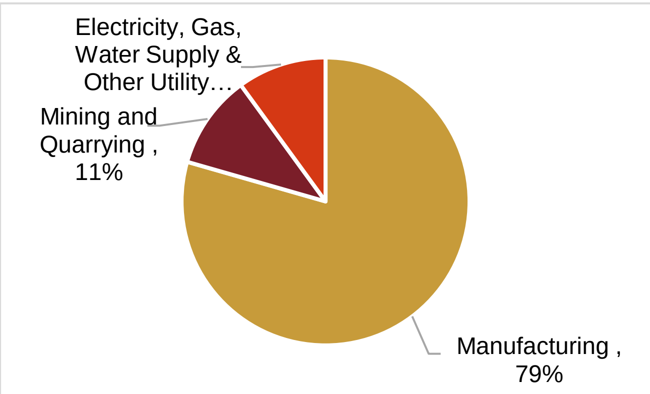
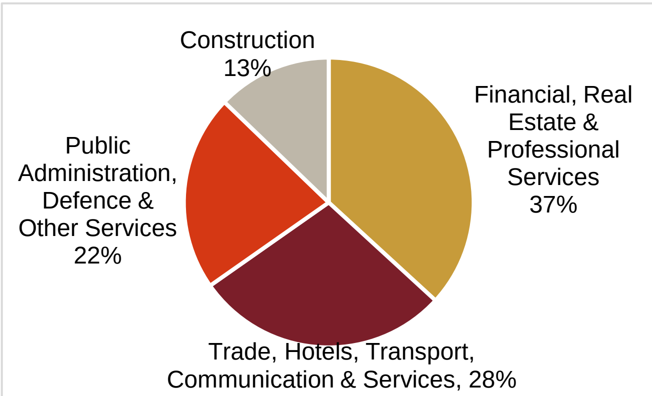
As compared to various developed economies, which witnessed a good contribution from manufacturing and industry first and subsequently in services, the Indian transformation story has been different. A notable feature of Indian economy has been the services sector's rising contribution to the overall output of the economy. Over fiscals 2018 to 2020, the service sector has grown at a rate of approximately 7%, thereby increasing the contribution of services sector to 65.6% in fiscal 2020 in terms of Gross Value Added (GVA) at constant prices. In fiscal 2022, overall GVA expanded by approximately 8.1% after contracting by 4.8% in fiscal 2021.

Share of sector in GVA at constant prices



Note: E – Estimated, P - Projected
Source: RBI; CRISIL Research

Industry and services sector can be further classified into sub-sectors. In industry, majority of the contribution comes from manufacturing sector which expanded by 10% and in the services sectors, highest contribution comes from financial, real estate and professional services segment which witnessed a growth of 4%.

Share of sub-sectors in GVA by Industry (FY22)	**Share of sub-sectors in GVA by Services (FY22)**
	

Note: GVA share is calculated from GVA at Basic Prices (at 2011-2012 Prices)
Source: RBI, CRISIL Research

Budget turns expansionary with an eye on medium term

The Union Budget 2022-23 bet big on an investment push to lift economic growth, two years and three waves into the COVID-19 pandemic. The idea is to push the growth multiplier rather than stoke consumption through direct budgetary support. For fiscal 2023, the government's revenue expenditure is budgeted to grow less than 1% after growing 2.7% in fiscal 2022. The total capex of the government (budgetary capex plus revenue grants for capital creation and capex by central public sector enterprises) is budgeted to rise 14.5% as compared with only 3.1% in the current fiscal. The government thus has tightened the belt around revenue expenditure and frontloaded infrastructure spending that is expected to lead to faster economic growth.

Among the sectors, infrastructure continues to be in the bright spot with a 30% hike in budgetary support. In addition, railways, water and green energy has also received strong impetus. The overarching picture is that the Union Budget 2022-23 sets the tone for much-needed infrastructure growth for the next 3-4 years. That is expected to help both, sustain development and create jobs. But implementation, which is all-crucial, remains the elephant in the room.

Broadly, the budget had the below key highlights:

- **Push for Capex**

Significantly, the Union Budget 2022-23 chose to push the pedal on investment at this juncture resulting into a rise in budgetary capex which is projected to increase in fiscal 2023. Studies highlight that the positive spill over effects of public investment only amplify during periods of uncertainty. For the Indian economy specifically, capital expenditure (capex) typically has higher multiplier effect than revenue spending, by crowding in private investment.

- **Improved spending quality**

While maintaining focus on capex, the Union Budget 2022-23 also allowed for some normalisation of extraordinary spending that took place in response to the COVID-19 pandemic. In fiscal 2023, Indian government spending is budgeted to grow less than 1% as compared to 2.7% in fiscal 2022. That said, it also attempts to reduce revenue spends (spending towards Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA), food subsidies to Food Corporation of India) after deducting grants for capital creation, only to support capex and provide a stimulus to the Indian economy.

- **Leg up to the manufacturing sector**

Manufacturing sector was in doldrums even before the COVID-19 pandemic struck and was affected in a worse manner in fiscal 2021 along with the services sector. The Union Budget 2022-23 announced more measures to address that in continuation with the Aatmanirbhar Bharat package and Production-Linked Incentive (PLI) scheme, such as total outlay under the PLI scheme for manufacturing of high-efficiency solar modules has been increased by Rs. 195 billion, taking it to Rs. 240 billion. The Indian government has also budgeted Rs. 74 billion under the PLI scheme across 10 sectors for fiscal 2023. CRISIL Research estimates that the PLI scheme will entail Rs. 2.5-3.0 trillion capex and generate incremental revenue of Rs. 30-35 trillion over its tenure, auguring well for private capex recovery.

- **Continuing transparency**

In efforts to improve transparency, the Indian government has reduced its recourse to off-budget borrowings in the Union Budget 2022-23 and is gradually paying back the public sector enterprises it has borrowed from. In the past, the Indian government funded subsidies on items such as food, fertilisers, and oil by way of special bonds raised through the FCI, fertiliser companies and oil marketing companies (OMCs). According to the statement of liabilities, these debts are being paid down and have come down to Rs. 1.5 trillion in fiscal 2022 from Rs.1.6 trillion in fiscal 2021. This is further budgeted to decline to Rs. 1.4 trillion by end of fiscal 2023.

- **An eye on medium term**

A higher fiscal deficit number (of 6.9% of GDP as compared to 6.8% budgeted for fiscal 2022), a small reduction (to 6.4%) in fiscal 2023 and a gradual reduction to 4.5% by fiscal 2026, is expected to create some room for spending in fiscal 2022 as well over the medium term. The Indian government plans to use the additional space to drive public investments in infrastructure and create employment.

It also tries to lift the medium-term growth potential through a sharper focus on financial sector reforms such as:

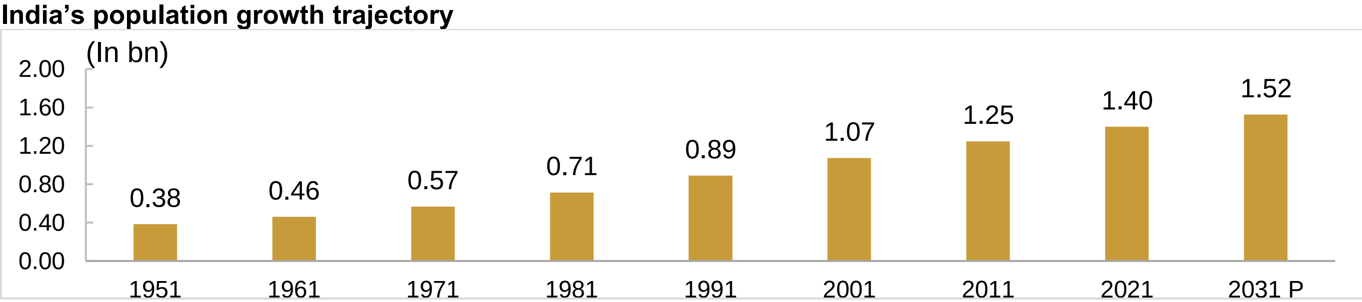
- **Deepening Financial Inclusion:** In another progressive step for the financial sector, the Indian Government, in the Union Budget 2022-23, also announced its intention to add 0.15 million post offices to the core banking system to enable financial inclusion and access to accounts through net and mobile banking, and ATMs and provide online fund transfers between post office and bank accounts
- **Extending ECLGS:** The allocation under Emergency Credit Line Guarantee Scheme (ECLGS) has been increased from Rs. 4.5 trillion to Rs. 5.0 trillion and the timeline for sanctions has been extended to March 2023. However, the enhancement of Rs. 500 billion has been earmarked exclusively for hospitality and related enterprises, which have been impacted the most due to the COVID-19 pandemic.

Key growth drivers

India has world's second largest population

As per Census 2011, India's population was ~1.25 billion, and comprised nearly 245 million households. The population, which grew at nearly 1.5% CAGR between 2001 and 2011, is expected to increase at 1.1% CAGR between 2011 and 2021, to 1.4 billion. The population is expected to reach 1.5 billion by 2031, and number of households are expected to reach ~376 million over the same period.

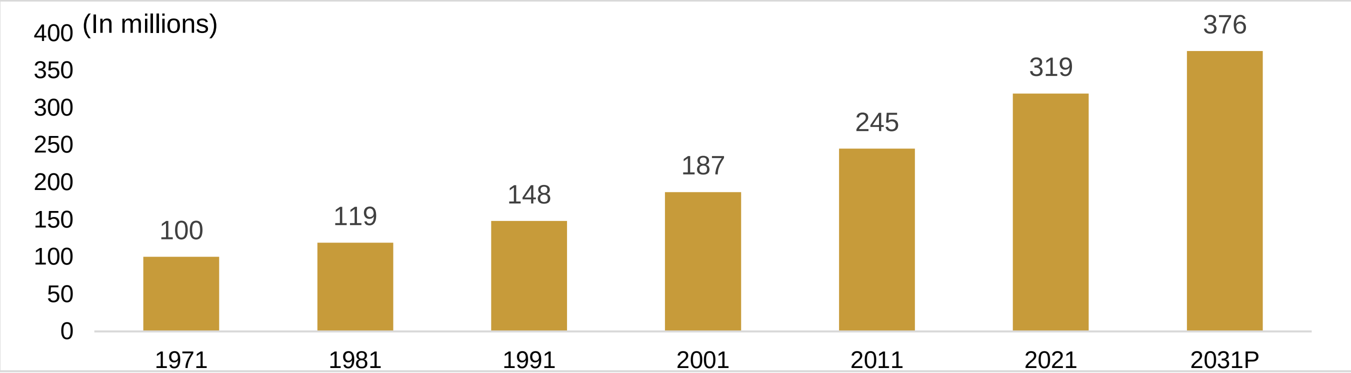
India's population growth trajectory



Note: P: Projected
Source: United Nations Department of Economic and Social affairs[1], CRISIL Research

[1] *https://population.un.org/wpp/*

Number of households in India

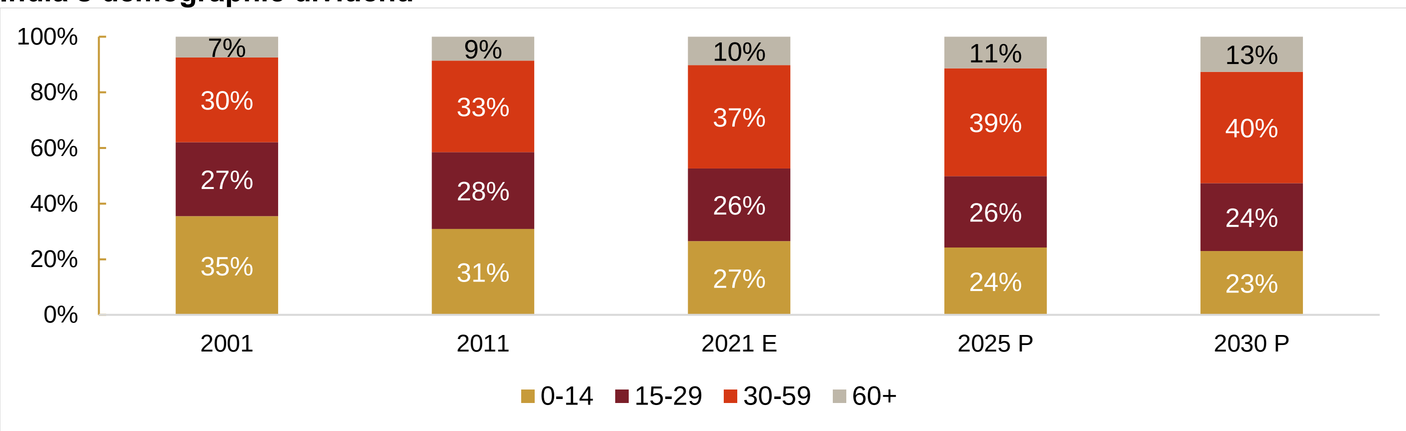


Note: P: Projected
Source: Census India, CRISIL Research

Favourable demographics

As of calendar year 2020, India has one of the largest young populations in the world, with a median age of 28 years. CRISIL Research estimates that approximately 90% of Indians are still below the age of 60 in calendar year 2021 and that 63% of them are between 15 and 59 years. In comparison, in calendar year 2020, the United States (US), China and Brazil had 77%, 83% and 86%, respectively, of their population below the age of 60.

India's demographic dividend



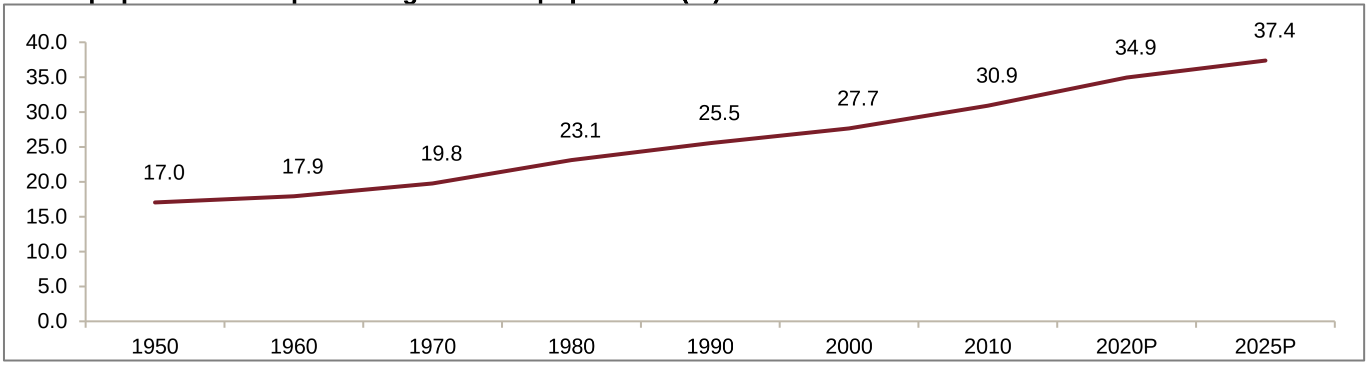
Note: E: Estimated, P: Projected
Source: United Nations Department of Economic and Social affairs[2], CRISIL Research

Urbanisation

Urbanisation is one of India's most important economic growth drivers. It is expected to drive substantial investments in infrastructure development, which in turn is expected to create jobs, develop modern consumer services and increase the ability to mobilise savings. India's urban population has been rising consistently over the decades. In 1950, it was 17% of total population. As per the 2018 revision of World Urbanization prospects, it was estimated at 34.9% for India. This is expected to reach 37.4% by 2025.

[2] *https://population.un.org/wpp/*

Urban population as a percentage of total population (%)



Note: P - projected
Source: Census 2011, World Urbanization Prospects: The 2018 Revision (UN)

Increasing per capita GDP

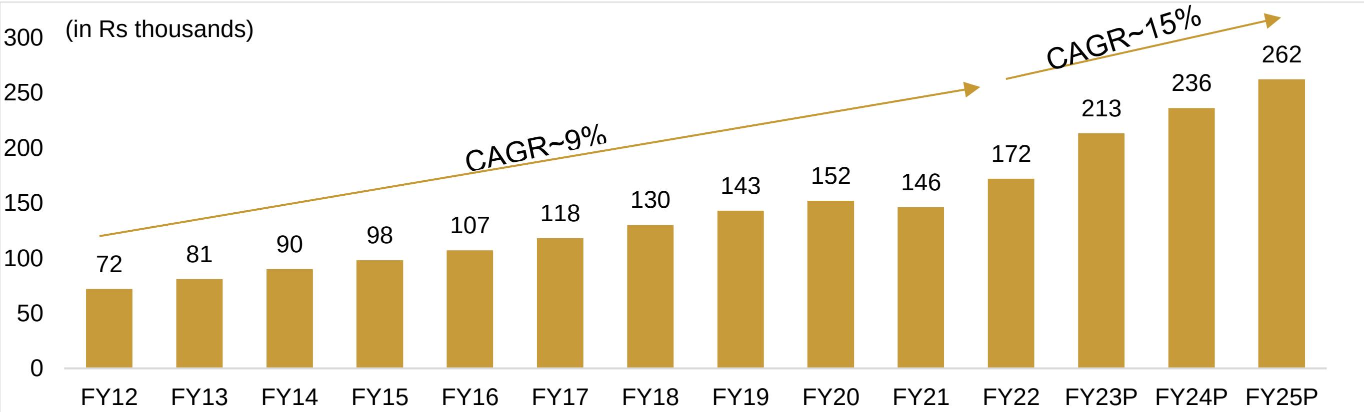
In fiscal 2022, India's per capita income expanded by 7.6%. As per IMF estimates, India's per capita income (at constant prices) is expected to grow at 6% compound annual growth rate (CAGR) from fiscals 2022-25.

Per capita income	Level in FY22 (INR '000)		Growth at constant prices (%)										
	Current prices	Constant prices	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY25 P
	172	107	3.3	4.6	6.2	6.7	6.8	5.7	5.8	2.9	-7.6	7.6	6.0*

Note – P: Projected, (*) - 3-year CAGR growth (FY22-FY25), As per IMF estimates of April 2022
Source – Ministry of Statistics and Program Implementation (MOSPI), International Monetary Fund (IMF), CRISIL Research

As per IMF's estimates, India's nominal GDP per capita (at current prices) is projected to increase at a CAGR of 15% from FY22 to FY25.

Trend in Nominal GDP per capita (at current prices)

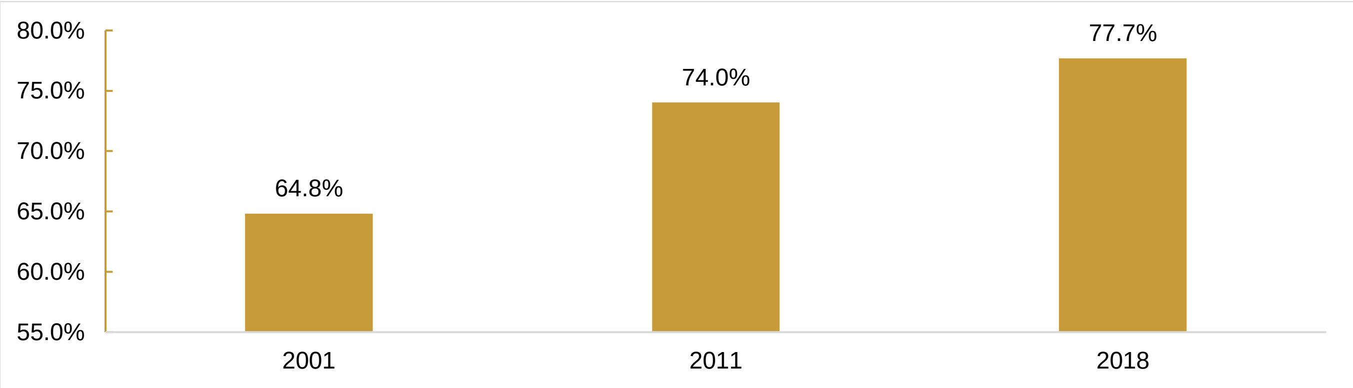


Note: P- Projected; FY23-FY25 Data projected as per IMF estimates
Source: MOSPI, IMF, CRISIL Research

Financial penetration to rise with increase in awareness of financial products

Overall literacy in India is at 77.7% as per the results of recent NSSO survey conducted in 2018 which is still below the world literacy rate of 86.5%. However, according to the National Financial Literacy and Inclusion Survey (NCFE-FLIS) 2019, only 27% of Indian population is financially literate indicating huge gap and potential for financial services industry. The survey defines financial literacy as combination of awareness, knowledge, skill, attitude and behaviour necessary to make sound financial decisions and ultimately achieve individual financial wellbeing.

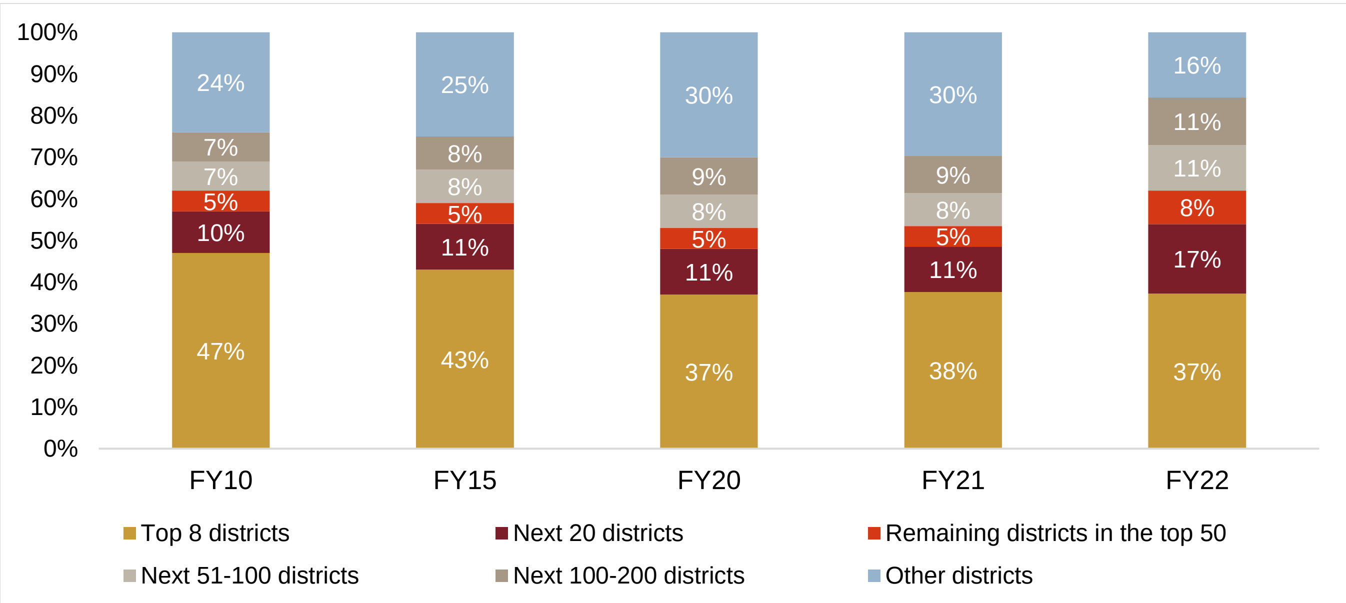
Overall literacy rate on a rise in India



Source: Census 2011, NSO Survey on household social consumption (2017-18),CRISIL Research

With increasing financial literacy, mobile penetration, awareness and the Prime Minister's Jan Dhan Yojana bank accounts (scheme aimed at bringing the unbanked under the formal banking system), there has been a rise in the participation of individuals from non-metro cities in banking. With more people attached to the formal banking sector, the demand for financial products in smaller cities has seen a major uptick in recent years. Going forward, CRISIL expects financial penetration to increase on account of increasing financial literacy.

Share of top 8 cities in banking deposits exhibits a reducing trend indicating increasing financial penetration



Note: 1) Classification of districts is done based on population as per Census 2011.
2) Mumbai Metropolitan Region (MMR), National Capital Region (NCR), Bengaluru and Kanpur have each been considered as a district.

3) MMR includes Thane and Mumbai, NCR includes Delhi, Gurugram, Gautam Buddha Nagar, Ghaziabad and Faridabad, Bengaluru includes Bangalore Urban and Bangalore Rural, Kanpur includes Kanpur Nagar and Kanpur Dehat
Source: RBI, CRISIL Research

Digitisation aided by technology to play pivotal role in growth of economy

Technology is expected to play an important role by progressively reducing the cost of reaching out to smaller markets. India has seen a tremendous rise in fintech adoption in the past few years and has the highest fintech adoption rate globally of 87% which is significantly higher than the global average rate of 64% *(Source: InvestIndia)*. Among many initiatives by the government, the Unified Payments Interface (UPI) is playing a pivotal role towards financial inclusion. It provides a single-click digital interface across all system for smartphones linked to bank accounts and facilitates easy transactions using a simple authentication method. The volume of digital transactions has also seen a surge in the past few years, driven by increased adoption of UPI. Apart from financial services industry, digitisation in other industries like retail will also play an important role in growth of economy.

UPI usage data statistics

As of month end	No of banks live on UPI	Volume of transactions (million)	Amount of transactions (Rs. billion)	YoY growth (on value basis) in transactions (%)
March 2018	91	178	242	764%
March 2019	142	800	1,335	452%
March 2020	148	1,247	2,065	55%
March 2021	216	2,731	5,048	210%
March 2022	314	5,406	9,606	90%
April 2022	316	5,583	9,833	99%
May 2022	323	5,995	10,415	112%
June 2022	-	5,863	10,144	85%
July 2022	-	6,288	10,630	75%
August 2022	-	6,580	10,728	68%

Source: National Payments Corporation of India (NPCI)

Over the years, India has witnessed a strong push from government to improve the digital payments infrastructure in the country. On August 2, 2021, a digital payment instrument, namely e-RUPI, was launched. This instrument is developed over the existing UPI platform by National Payments Corporation of India (NPCI), in collaboration with Department of Financial Services, Ministry of Health and Family Welfare and the National Health Authority. e-RUPI is a cashless and contactless instrument for digital payment. It is a QR code or SMS string-based e-voucher, which is delivered to the mobile of the beneficiaries. The users of this seamless one-time payment mechanism will be able to redeem the voucher without a card, digital payments app or internet banking access, at the merchants accepting e-RUPI. e-RUPI would be shared with the beneficiaries for a specific purpose or activity by organizations or Government via SMS or QR code.

Measures to counter the pandemic's onslaught on growth

Reserve Bank of India goes all out to combat the crisis

The Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) slashed the repo rate by 115 basis points (bps) to address financial market stress in the wake of the COVID-19 pandemic and the subsequent lockdown. In an unusual move, the MPC also asymmetrically slashed the reverse repo initially by 90 bps and by another 25 bps and 40 bps subsequently.

The RBI also announced a host of other measures to address financial market stress due to the pandemic / lockdown:

- **Reducing debt servicing burden through moratorium period:** The RBI initially permitted lending institutions to allow a moratorium of three months on repayment of instalments for term loans outstanding as on March 1, 2020, and defer interest payments due on working capital facilities outstanding.

- **Loan restructuring:** The central bank constituted a committee which identified 26 sectors for restructuring which included aspects related to leverage, liquidity and debt serviceability to be factored by the lending institutions while finalising resolution plans for borrowers.

- **Enhancing liquidity**: Apart from reducing repo and reverse repo rate, the RBI reduced the cash reserve ratio (CRR) requirements of all banks by 100 bps to 3% of net demand and time liabilities (NDTL).

- **Supporting financial market liquidity:** The RBI initially announced targeted long-term repo operations (TLTROs) of up to three years' tenure for a total of up to Rs. 1 trillion. Liquidity availed under the scheme by banks had to be deployed in investment grade corporate bonds, commercial paper, and non-convertible debentures.

- **Measures during second wave of COVID-19:** In May 2021, RBI announced several measures to protect small and medium businesses and individual borrowers from the adverse impact of the intense second wave of COVID-19 across the country. Resolution framework 2.0 was announced wherein individuals and MSMEs having aggregate loan exposure of up to Rs. 250 million, who have not availed restructuring under any of the earlier restructuring frameworks (including under the Resolution Framework 1.0 dated August 6, 2020), and who were classified as 'Standard' as on March 31, 2021, were allowed to restructure their loans.

'Aatmanirbhar' package is a timely relief amid the pandemic

Liquidity boost for NBFCs

The Indian government announced a Rs. 450 billion partial guarantee scheme (for NBFCs) and Rs. 300 billion special liquidity scheme for NBFCs, housing finance companies (HFCs) and MFIs, aimed at covering the concern of credit risk perception on mid and small size non-banks.

Emergency Credit Line Guarantee Scheme (ECLGS) for MSMEs (Rs. 4.5 trillion)

Banks and NBFCs are directed to offer up to 20% of entire outstanding credit to MSMEs. MSMEs with up to Rs. 250 million outstanding credits and Rs. 1 billion turnover are eligible for these loans.

Subordinated debt to MSMEs (Rs. 200 billion)

The Indian government is also facilitating the provision of Rs. 200 billion as subordinate debt for stressed assets of MSMEs. It will also provide Rs. 40 billion as partial credit guarantee support to banks for lending to MSMEs.

Equity infusion in MSMEs (Rs. 500 billion)

The Government has committed to infuse Rs. 500 billion in equity of MSMEs having growth potential and viability. It will also encourage MSMEs to list on stock exchanges.

Clearing MSME dues; guarantee scheme

The Government has requested central public sector enterprises to release all pending MSME payments within 45 days. It will boost transaction-based lending by fintech enterprises.

Global tenders disallowed up to Rs. 2 billion

The Indian government will not allow foreign companies in government procurement tenders of value up to Rs. 2 billion. This is likely to ease the competition faced by the MSMEs against foreign companies.

Loan interest subvention scheme (Rs. 15 billon)

Under this scheme, the Indian government has provided 2% interest subvention for loans given under Mudra-Shishu scheme. These loans are up to the ticket size of Rs. 50,000 and are mostly given by NBFC-MFIs that benefit low-income groups customers.

Special credit facility for street vendors (Rs. 50 billon)

The Government announced this scheme to facilitate easy access of credit to street vendors to offset the adverse effect of pandemic on their livelihoods.

‘Aatmanirbhar 3.0’ stimulus package rolled out to boost economy in November 2020

The finance minister, on November 12, 2020, announced a stimulus package amounting to Rs 2.65 trillion. Under the package, 12 stimulus measures were rolled out to, among other things, boost employment in the formal and informal economy, help housing infrastructure, enhance ease of doing business and extend the deadline for the Credit Line Guarantee Scheme.

Following are the twelve announcements made in the Aatmanirbhar 3.0 stimulus package:

1. Aatmanirbhar Bharat Rozgar Yojana: Aatmanirbhar Bharat Rozgar Yojana, operational during October 1, 2020 to June 2021 to incentivise creation of new employment opportunities during COVID recovery phase.

2. Emergency credit line guarantee scheme 2.0: Launch of an emergency credit line guarantee scheme 2.0 for guaranteed credit to 26 stressed sectors. Emergency credit line guarantee scheme extended till March 31 2021.

3. PLI scheme: Introduction of the PLI scheme in 13 key sectors for enhancing India's manufacturing capabilities and exports.

4. PMAY **–** Urban**:** Rs. 180 billion will be provided over the Budged Estimates for 2020-21 for PM Awaas Yojana (PMAY) **-** Urban through additional allocation and extra-budgetary resources.

5. Support for construction and infrastructure **-** Relaxation of earnest money deposit (EMD) and performance security on Government tenders.
    - Performance security on contracts to be reduced to 3% instead of 5-10%
    - EMD will not be required for tenders and will be replaced by Bid Security Declaration
    - Relaxations will be given till December 31, 2021

6. Demand booster for residential real estate income-tax relief for developers and home buyers: Increase in the differential from 10% to 20% for the period from the date of the announcements to June 20, 2021 for only primary sale of residential units of value up to Rs. 2 billion.

7. Government will invest Rs. 60 billion as equity in the NIIF debt platform. Infra project financing of Rs. 1.1 trillion will be provided by the Government.

8. Government will provide support to farmers with Rs. 650 billion for subsidised fertilisers

9. Boost for the rural employment -Enhanced outlays under PM Garib Kalyan Rozgar Yojana: Rs. 400 billion was additionally provided in Atmanirbhar Bharat 1.0. Further outlay of Rs. 100 billion to be provided for PM Garib Kalyan Rozgar Yojana in the current Fiscal.

10. Boost for exports – Rs. 30 billion to EXIM Bank for lines of credit: Rs. 30 billion will be released to EXIM Bank for promotion of project exports through lines of credit under the IDEAS scheme.

11. Capital and industrial stimulus: Rs. 102 billion additional budget outlay will be provided towards capital and industrial expenditure.

12. Research and development grant for COVID-19 vaccine development: Rs. 9 billion provided for COVID Suraksha Mission for research and development of an Indian COVID-19 vaccine to the Department of Biotechnology

'Scope of ECLGS Scheme further expanded post the COVID-19 second wave

In September 2021, with a view to support various businesses impacted by the second wave of COVID 19 pandemic, the timeline for ECLGS has been extended till March 2022 or till guarantees for an amount of Rs 4.5 lakh crore is issued under the scheme, whichever is earlier. As of December 2021, loans sanctioned have crossed Rs 3.19 trillion under the scheme.

In June 2021, the government increased the overall admissible guarantee limit from Rs 3.0 trillion to Rs 4.5 trillion. In addition, the limit of admissible guarantee and outstanding loan amount is increased from 20% to 40% of outstanding for COVID-affected sectors like Hospitality sector, Travel & Tourism sector, Leisure & Sporting sector and Civil Aviation sector, subject to a maximum of Rs.200 crore per borrower.

Earlier, in May 2021, the Government announced the following further modifications to the ECLGS scheme:

- The scope was expanded to cover loans up to Rs. 20 million to hospitals/nursing homes/clinics/medical colleges for setting up on-site oxygen generation plants with interest rate capped at 7.5%
- Additional ECLGS assistance of up to 10% of the outstanding loans as on February 29, 2020 was allowed to borrowers covered under ECLGS 1.0
- Civil Aviation sector was included in the list of sectors covered
- Ceiling of Rs. 5 billion of loan outstanding for eligibility under ECLGS 3.0 was removed, subject to maximum additional ECLGS assistance to each borrower being limited to 40% or Rs. 2 billion, whichever was lower
- Borrowers who had availed loans under ECLGS 1.0 of overall tenure of 4 years comprising of repayment of interest only during the first 12 months with repayment of principal and interest in 36 months were allowed to increase the tenure to 5 years (repayment of interest only for the first 24 months with repayment of principal and interest in 36 months thereafter)

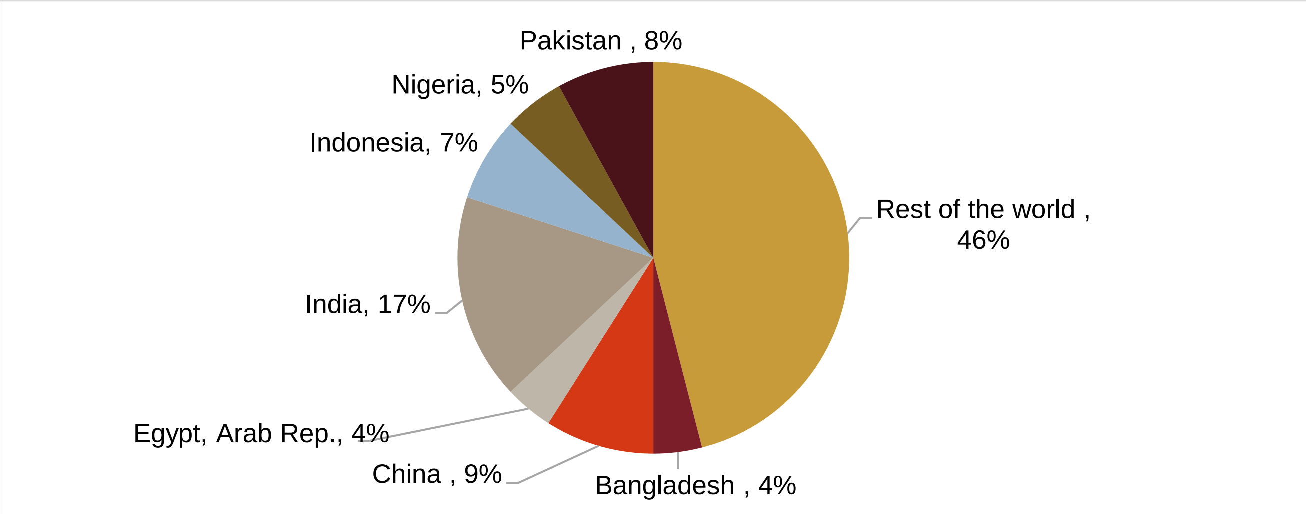
Key structural reforms: Long-term positives for the Indian economy

Financial inclusion

According to the World Bank's Global Findex Database 2021, the global average of adult population with an account (with a bank, financial institution, or mobile money providers) was ~76% in 2021. India's financial inclusion has improved significantly between 2014 and 2021, with the adult population with bank accounts rising from 53% (as per Global Findex Database 2014) to 78% in 2021 with concentrated efforts by the government to promote financial inclusion and the proliferation of supporting institutions. That said the rise in the number of bank accounts has not translated into a corresponding increase in the number of transactions and fruitful usage of those accounts.

As per the Global Findex Database 2021, ~50% of the world's unbanked adults are in India, Bangladesh, China, Egypt, Indonesia, Nigeria and Pakistan. Of the world's total unbanked adults (~1.4 billion), 54% of the unbanked, 740 million are from just these seven countries. India (17% or 230 million) and China (9% or 130 million), despite having high rates of account ownership, have the highest share of unbanked adults in the world because of their huge population.

More than 50% of world's unbanked population lives in seven economies



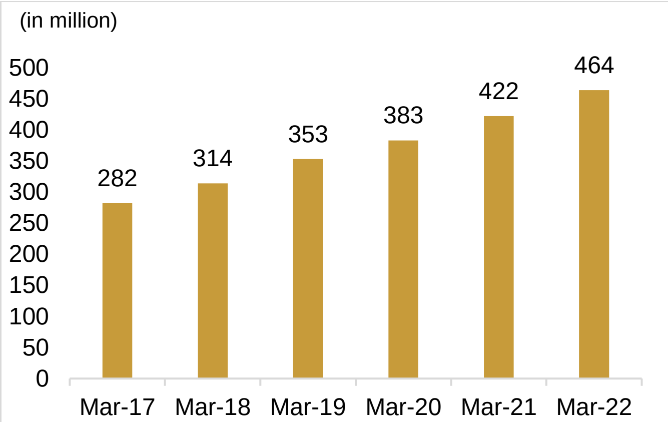
Adults with no account (%), 2021
Source: World Bank - The Global Findex Database 2021, CRISIL Research

The two key initiatives launched by the government to promote financial inclusion are the Pradhan Mantri Jan Dhan Yojana (PMJDY) and Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY). Under the PMJDY, the government's aim is to ensure that every household in India has a bank account which they can access from anywhere and avail of all financial services such as savings and deposit accounts, remittances, credit and insurance affordably. PMJJBY is a one-year life insurance scheme that offers a life cover of Rs 0.2 million at a premium of Rs 330 per annum per member, which can be renewed every year. The government has also launched the Pradhan Mantri Suraksha Bima Yojana (PMSBY), which is an accident insurance policy and offers an accidental death and full disability cover of Rs 0.2 million at a premium of Rs 12 annually. As per the Government of India, more than 100 million people have registered for these two social security schemes.

Pradhan Mantri Jan Dhan Yojana (PMJDY), launched in August 2014, is aimed at ensuring ensure that every household in India has a bank account which they can access from anywhere and avail of all financial services such as savings and deposit accounts, remittances, credit and insurance affordably. PMJDY focuses on household coverage compared with the earlier schemes that focused on coverage of villages. It aims to extend banking facilities to all within a reasonable distance in each sub-service area (consisting of 1,000-1,500 households) across India.

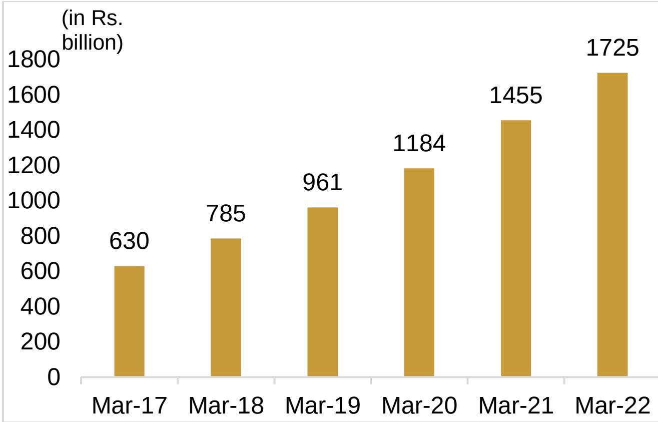
As on March 31, 2022, 464 million PMJDY accounts had been opened, of which, 67% were in rural and semi-urban areas, with total deposits of Rs 1,725 billion.

Number of PMJDY accounts



Source: PMJDY; CRISIL Research

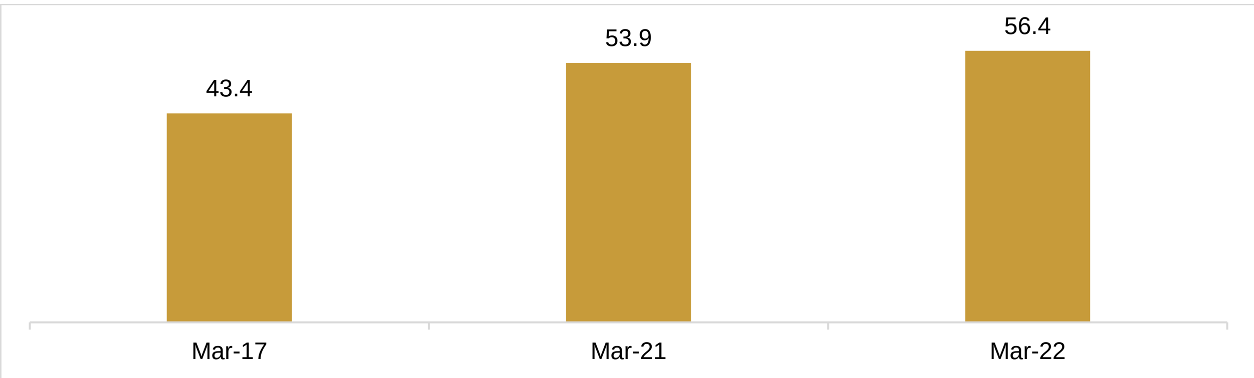
Total balance in PMJDY accounts



Source: PMJDY; CRISIL Research

In August 2021, RBI introduced an annual index to measure and improve the extent of financial inclusion in the country. The index covers details of banking, investments, insurance, postal and pension sector while arriving at the score. The index comprises of three broad parameters viz., Access (35% weightage), Usage (45% weightage), and Quality (20% weightage) with each of these consisting of various dimensions, which are computed based on a number of indicators. In total, the index has 97 indicators which are responsive to ease of access, availability and usage of services and quality of services. The index also captures the quality aspect indicated by factors such as financial literacy, consumer protection, and inequalities and deficiencies in services. The index, which has been constructed without any base year, captures broad aspects of financial inclusion in a single value ranging between 0 and 100, where 0 represents complete financial exclusion and 100 indicates full financial inclusion.

India's Financial Index Score



Source: RBI, CRISIL Research

(Financial inclusion is covered in greater detail in next chapter)

GST implementation

Introduced on July 1, 2017, the GST is an indirect tax regime that subsumed multiple cascading taxes levied by the central and state governments. Its implementation has spawned structural changes in the supply chain and logistics network in the country. The crux of the GST mechanism is input tax credit, which ensures more players in the supply chain come under the tax ambit. As supply from only registered taxpayers will get input tax credit, businesses and stakeholders will insist on registration of their suppliers and traders, leading to an increase in the share of organised participants. The GST regime has been stabilising fast and is expected to bring more transparency and increase in formalisation, eventually leading to higher economic growth.

PLI scheme to boost manufacturing in the long run

The government has budgeted ~Rs 2 trillion to give incentives to the locally manufacturing units to 13 key sectors. The key sectors expected to get benefit from the scheme include automobiles, pharma, telecom, electronics, food, textile, steel and energy. By incentivising production subject to achieving the desired scale, the scheme aims to spawn a handful of globally competitive large scale manufacturing units in the identified sectors. Furthermore, the government also hopes to reduce India's dependence on raw material imports from China. The scheme is expected to provide a boost to economic growth over the medium-term and create more employment opportunities as many of these sectors are labour intensive in nature.

<table>
<tr><th>Broad Sector</th><th>Segment</th><th colspan="2">Budgeted (Rs. Bn)*</th></tr>
<tr><td rowspan="2">Automobiles</td><td>Advance Chemistry Cell (ACC) Battery</td><td>181</td><td rowspan="2">441</td></tr>
<tr><td>Automobiles & auto components</td><td>260</td></tr>
<tr><td rowspan="3">Electronics</td><td>Mobile manufacturing and specified electronic Components</td><td>409</td><td rowspan="3">521</td></tr>
<tr><td>Electronic/technology products</td><td>50</td></tr>
<tr><td>White goods (ACs & LED)</td><td>62</td></tr>
<tr><td rowspan="3">Pharma and medical equipment</td><td>Critical key starting materials/drug intermediaries and active pharmaceutical ingredients</td><td>69</td><td rowspan="3">253</td></tr>
<tr><td>Manufacturing of medical devices.</td><td>34</td></tr>
<tr><td>Pharmaceuticals drugs</td><td>150</td></tr>
<tr><td>Telecom</td><td>Telecom & networking products</td><td>122</td><td>122</td></tr>
<tr><td>Food</td><td>Food products</td><td>109</td><td>109</td></tr>
<tr><td>Textile</td><td>Textile products: MMF segment and technical textiles</td><td>107</td><td>107</td></tr>
<tr><td>Steel</td><td>Speciality steel</td><td>63</td><td>63</td></tr>
<tr><td>Energy</td><td>High efficiency solar PV modules</td><td>45</td><td>45</td></tr>
<tr><td>Total</td><td colspan="2"></td><td>1662</td></tr>
</table>

**Approved financial outlay over a five-year period*
Source: Government websites; CRISIL Research

Thrust on affordable housing

The residential real estate segment saw two policy changes – Real Estate (Regulation and Development) Act (RERA) and Goods and Services Tax (GST) -- which had a direct impact on the sector's demand-supply dynamics. Consequently, new launches dropped sharply, with developers focussing on completing ongoing projects. The sector had been battling weak demand for the past couple of years, and one of the key reasons was unaffordability, as developers focussed on the middle and premium income-category projects. However, government initiatives have prompted developers to explore affordable housing as a new area. Going ahead, about half of the incremental supply being added in urban stock is expected to be via affordable housing. Additionally, the formalisation of the industry is likely to bring in more transparency, leading to an increase in consumer demand.

In a major relief to real estate sector, the government has extended the timelines of RERA projects by six months for projects expiring on or after March 25, 2020. Further, in affordable housing, it has extended the deadline to March 31, 2022, for first time homebuyers to avail additional Rs 150,000 interest deduction on home loans.

PMAY U and G have been focused to provide affordable housing for lower income group and Economic weaker section households which is nothing but affordable housing in country. The government remains focused on the PMAY U and G, and as of September, 2022, construction of close to 26.3 million homes across urban and rural regions have been completed.

PMAY Gramin (Rural)

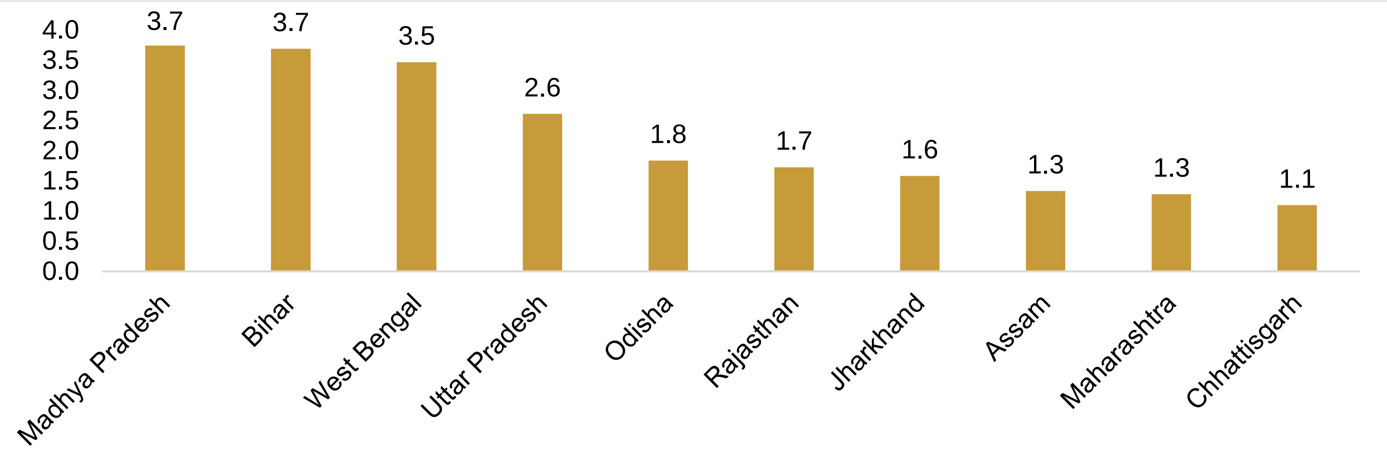
Under the PMAY-Gramin (PMAY-G), as many as 20.0 million houses were completed as of September 26, 2022. The government has set up a target of constructing 29.5 million houses by fiscal 2024 under the scheme. Out of the overall target, a target of 27.0 million houses as already been allocated to States/Union Territories as of July 2022. CRISIL Research believes budgetary allocation for the scheme is insufficient. As a result, it will have to rely heavily on extra budgetary resources raised through NABARD bonds. Till September 26, 2022, around 24.6 million houses were sanctioned under PMAY Gramin.

PMAY G status (as of September 26, 2022)

	Target (MoRD)	Sanctioned	Completed	Funds Released (Rs. trillion)
PMAY G	27,192,795	24,580,163	20,043,019	2.65

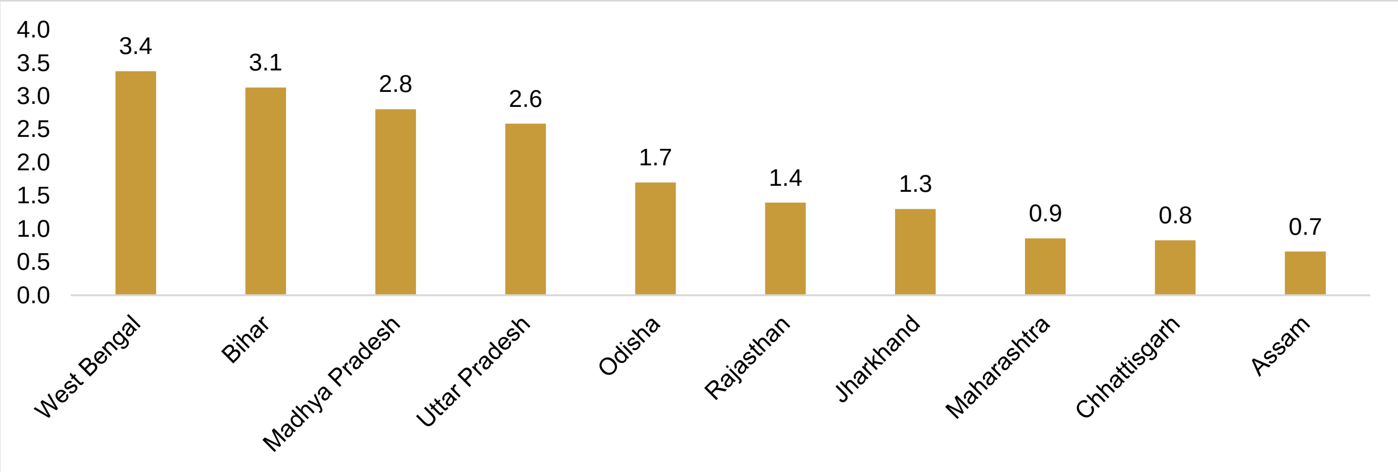
Note: MoRD: Ministry of Rural Development, Source: PMAY-G, CRISIL Research

PMAY G – Houses Sanctioned (as on 26th September, 2022) – in millions



Source: PMAYG, CRISIL Research

PMAY G – House completed (as on 26th September, 2022) - in millions



Source: PMAYG, CRISIL Research

PMAY Urban

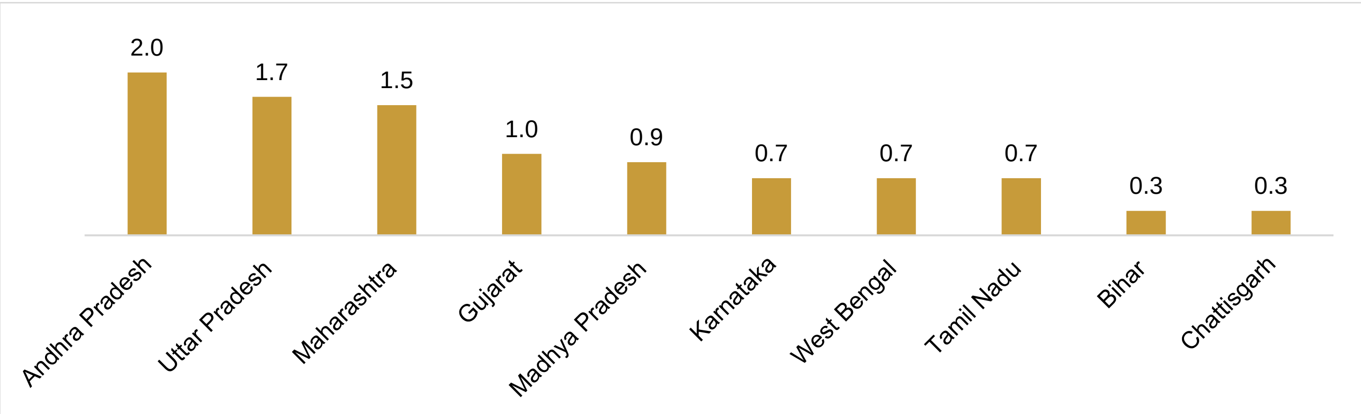
On 10th August 2022, the Union Cabinet approved the proposal of Ministry of Housing and Urban Affairs (MoHUA) for continuation of Pradhan Mantri Awas Yojana- Urban (PMAY-U) up to 31st December 2024, wherein financial assistance is to be provided for completion of all 122.69 lakh houses sanctioned till 31st March 2022. As on September 26, 2022, the Government has sanctioned ₹ 2.03 trillion towards this scheme. However, the central assistance released is about Rs 1.23 trillion, which amounts to approximately 60% of the required assistance. Like the PMAY-G, the PMAY-U also relies heavily on extra budgetary resources raised through Housing and Urban Development Corporation Ltd bonds. The flow of funds from the central government is crucial for the scheme's success.

PMAY U status (as of September 26, 2022)

	Target	Sanctioned (million)	Houses Grounded (million)	Completed (million)	Funds Released (Rs. Trillion)
PMAY U	Housing for All	12.26	10.36	6.28	1.23

Source: MOHUA, CRISIL Research

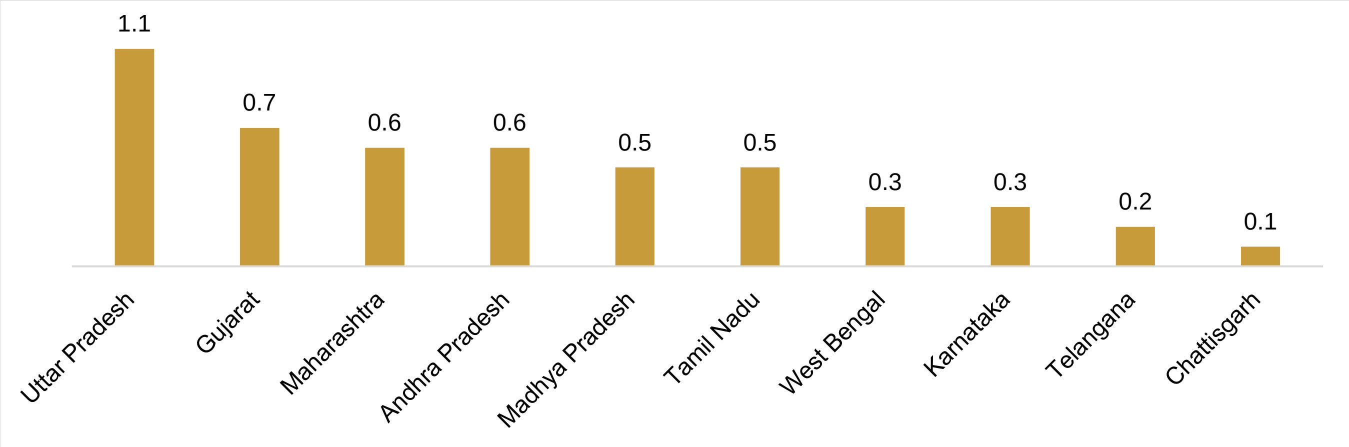
PMAY U – House sanctioned (As on 26th September 2022) - million



Source: MOHUA, CRISIL Research

Till September 2022, Andhra Pradesh state has the highest number of houses sanctioned followed by Uttar Pradesh and Maharashtra. These three states are followed by Gujarat, Madhya Pradesh and Karnataka.

PMAY U – House completed (As on 26th September 2022) - million



Source: MOHUA, CRISIL Research

IBC a key long-term structural positive

The Insolvency and Bankruptcy Code (IBC) is a reform that will structurally strengthen the identification and resolution of insolvency in India. Until November 2019, financial service providers were not covered under the IBC framework. In November 2019, the government notified the rules on applicability of IBC will cover NBFCs (including housing finance companies) with an asset size of Rs 5 billion or more. The IBC enhances the credit enforcement structure and provides certainty around the timeframes for insolvency resolution. It attempts to simplify legal processes, preserve value for creditors and provide them with greater certainty of outcome. With this reform, the RBI has sent a strong signal to borrowers to adhere to credit discipline and also encourage banks to break resolution deadlocks by introducing definite timelines. IBC will enhance investors' confidence when investing in India. Internationally, recovery rates have improved significantly after the implementation of bankruptcy reforms, as can be seen in the following table:

Country	Year of bankruptcy reform	Pre-reforms		Five years post-reforms	
		Recovery rate (%)	*Time (years)*	*Recovery rate (%)*	*Time (years)*
Brazil	2005	0.2	10.0	17.0	4.0
Russia	2009	28.2	3.8	42.8	2.0
China	2007	31.5	2.4	36.1	1.7
India	2016	26.0	4.3	43*	1.6*

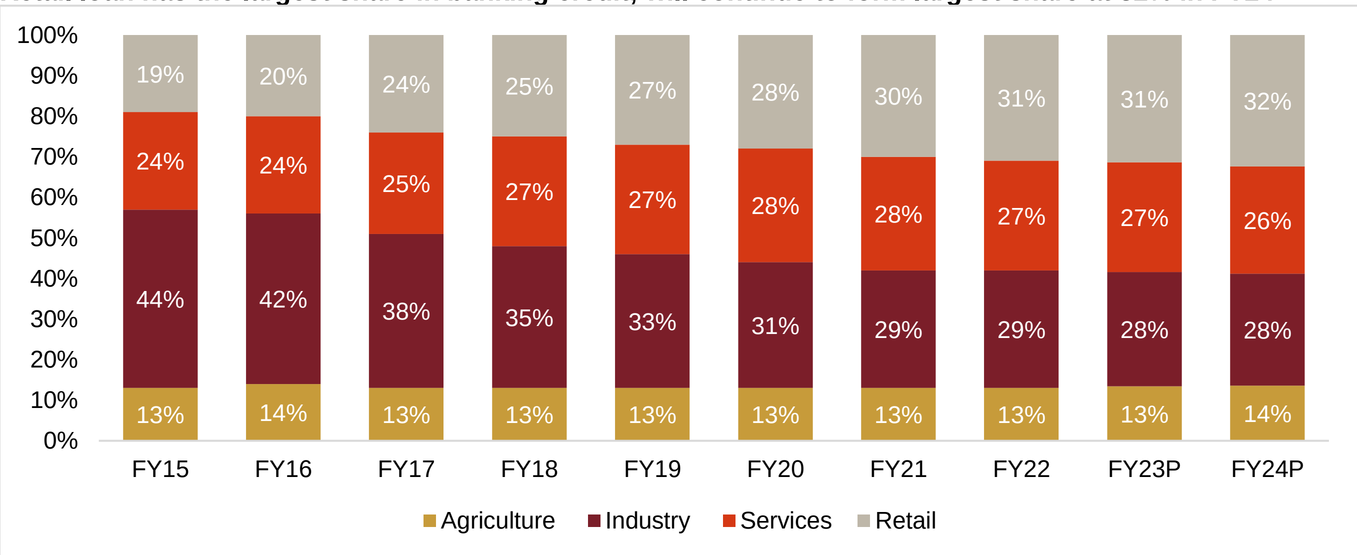
*Note: * As of 2019*
Source: World Bank, CRISIL Research

Credit penetration in India

Retail and agricultural sector to drive credit growth in fiscal 2023

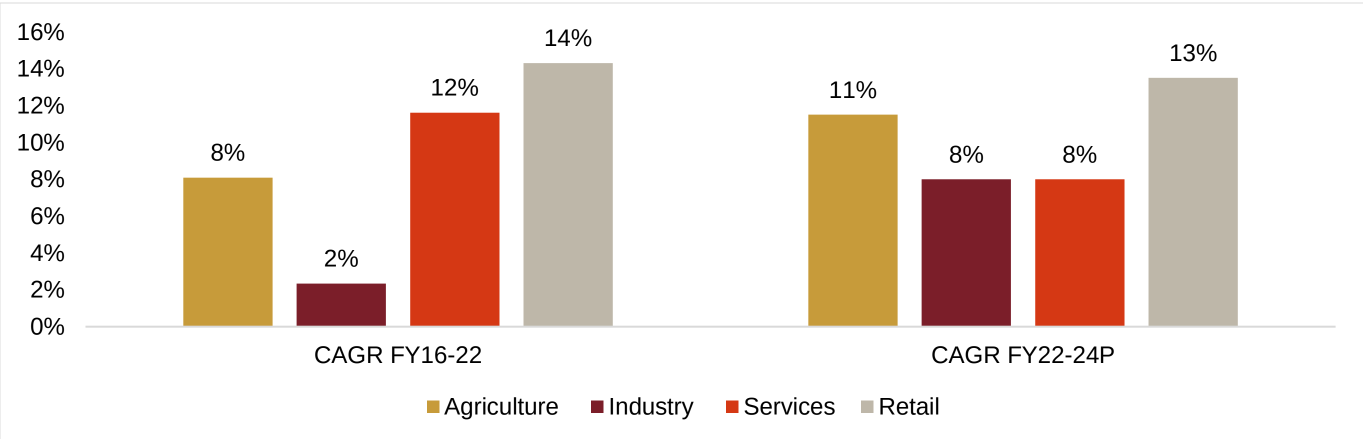
In the first half of fiscal 2022, the second wave of pandemic forced borrowers and lenders to drive business cautiously which ultimately led to muted bank growth. Growth picked up in the third quarter of fiscal 2022 which continued in the fourth quarter as well due to a much less potent third wave and pent-up demand. ECLGS scheme aided MSMEs to obtain credit from banking sector. CRISIL Research expects bank credit to grow 10-11% in fiscal 2023, driven by retail and agricultural segments and supported by recovery in services and industrial credit. Credit to agricultural sector was driven due to high commodity prices and high production in fiscal 2022. CRISIL Research expects agri-credit to grow at 11-13% during fiscal 2023 supported by higher PSL targets, higher food grain production and increased commodity prices. Credit to Industrial sector grew by 8% in in fiscal 2022 and CRSIL research expects it to maintain the growth momentum in fiscal 2023 and grow at 8-10%. Services segment credit is expected to grow at 8-10% on-year in fiscal 2023, led by increased lending towards NBFCs (which mainly lend to trade sector) and schemes such as ECLGS. Retail sector grew at 13% on-year due to low interest rates for housing loans. CRISIL expects continued credit growth towards retail sector in fiscal 2023 at 13-15%.

Retail loan has the largest share in banking credit; will continue to form largest share at 32% in FY24



Note: P: Projected
Source: RBI; CRISIL Research

Trend in growth of bank credit of various segments



Note: P: Projected
Source: RBI; CRISIL Research

Increasing retail penetration to support credit growth

Household debt-to-GDP ratio measures the credit penetration of the household sector in an economy. India ranks one of the lowest in this parameter. However, this ratio has been rising with increase in formalisation, rise in income levels, and improving banking penetration in the country. This is further supported by strong retail focus by banks, as this segment offers better risk-to-reward. We expect this pace to continue in medium term, given huge under-penetration in the segment, and supported by rapid growth in income levels.

Total credit-to-GDP ratio to pick up in the long-term on the back of structural reforms

Total credit-to-GDP ratio (total credit to for private non-financial sector), which measures the financial sector penetration in the economy, has been observed to be one of the lowest in case of India (~56% as of 2019) compared with other developing BRICS economies, such as China (~204%) and South Africa (~73%), and developed economies, such as the United States (~150%), United Kingdom (~163%) and France (~215%). Faster economic growth, improving digitisation initiatives, increasing banking penetration, and government's implementation of structural reforms such as IBC, augur well for the total credit to GDP ratio in the long term.

Greater credit penetration will increase proportion of new-to-credit customers

In India, the proportion of new-to-credit customers has been showing a steady increase across segments, indicating increasing comfort of the younger population in availing credit and a consequent increase in credit penetration. According to CRIF Highmark data, the proportion of new-to-credit (NTC) customers in fiscal 2022 was around, 41% in the case of business loans, 20% in the case of credit cards, 40% for personal loans, and 46% for auto loans.

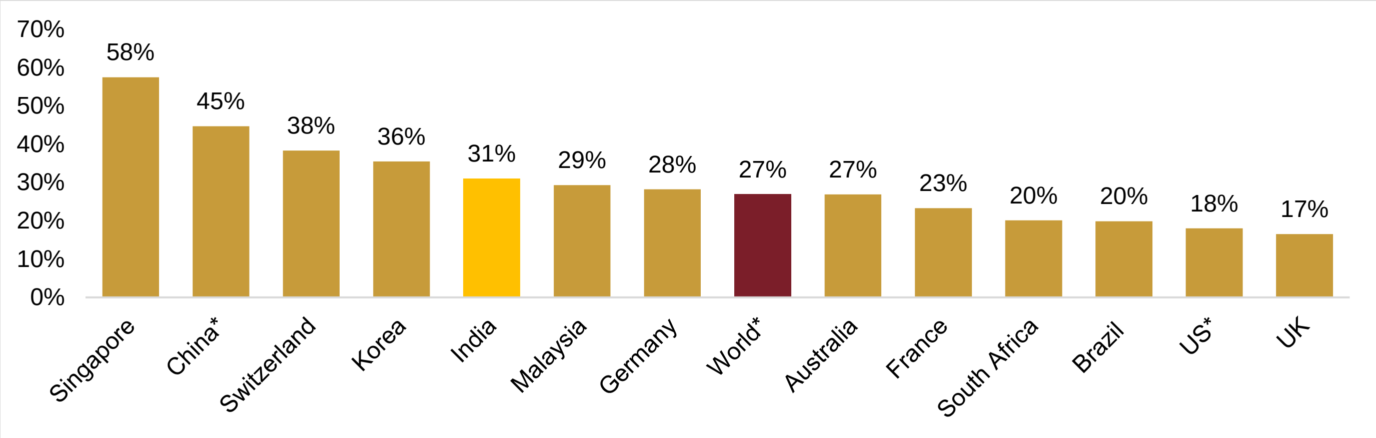
	Proportion of new-to-credit customers
Home loans	39%
Personal loans	40%
Credit cards	20%
Auto loans	46%
Business Loans	41%

NTC defined as loans with borrower vintage <= 12 months
Source: Industry, CRIF Highmark, CRISIL Research estimates

Household savings to increase

India’s slowing economy took a toll on much-needed savings too, with the savings rate touching a 15-year low in fiscal 2019 to 30.6%, and household savings also falling. Indian households contributed to about 62% of the country’s savings in fiscal 2020. However, India remains favourable in terms of gross domestic savings rate compared with most other emerging market peers at 31% in CY2021, greater than the world average of 27%.

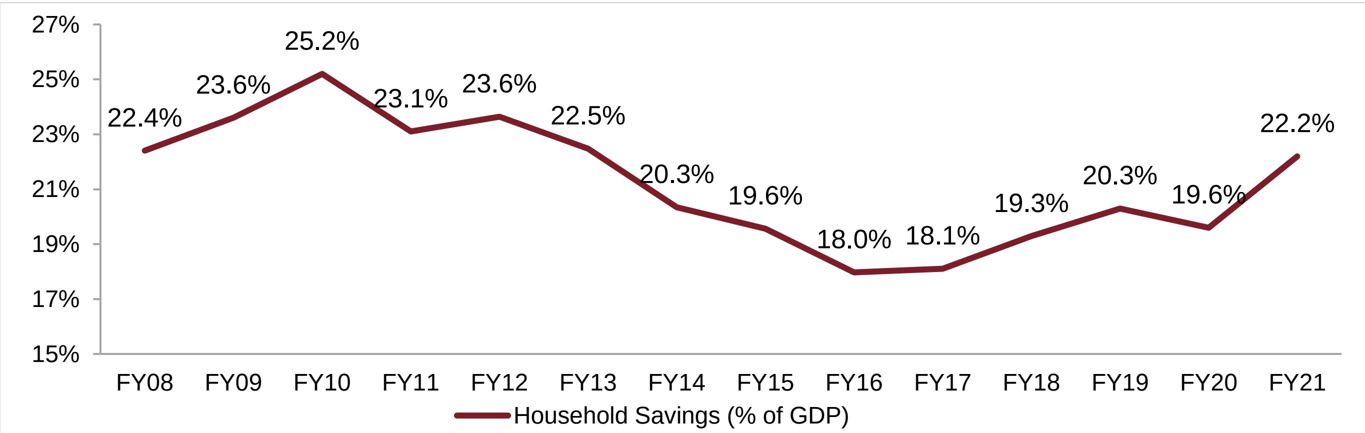
Gross Domestic Savings rate: India vs other countries (CY 2021)



Note: Gross Domestic Saving consists of savings of household sector, private corporate sector and public sector; (*) Data as of CY2020
Source: World Bank[3], Handbook of Statistics on Indian Economy 2020-21, RBI, MOSPI, CRISIL Research

Specifically, household savings as a percentage of GDP has been sliding since fiscal 2012, with its share as a proportion of GDP falling significantly from 23.6% in fiscal 2012 to 18.0% in fiscal 2016. The household savings as percentage of GDP rose to 22.2% in fiscal 2021 on account of liquidity.

Household savings as a percentage of GDP has increased to 22.2% in fiscal 2021



Note: E: Estimated, Source: Ministry of Statistics and Programme Implementation (MOSPI), RBI, CRISIL Research

Gross domestic savings trend

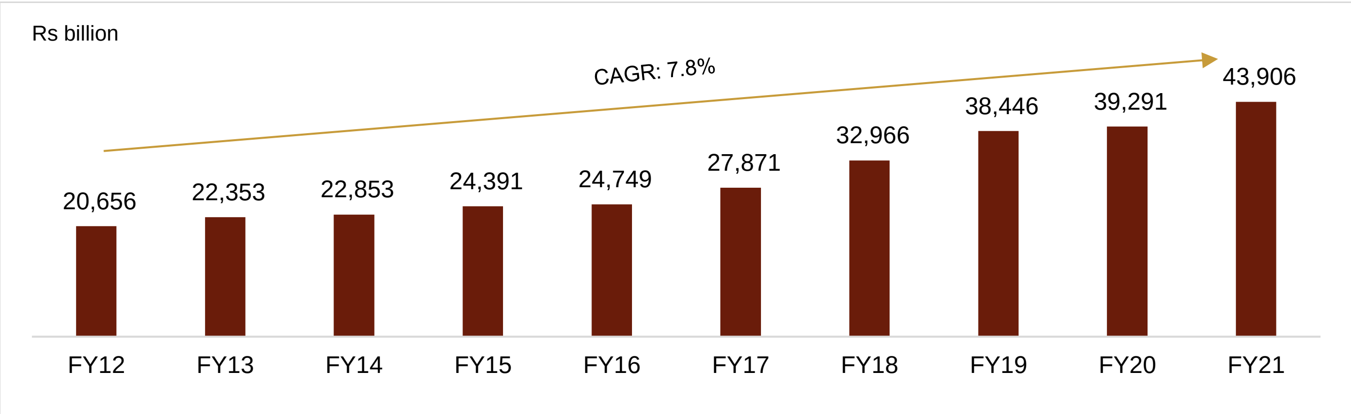
Parameters (Rs billion)	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21
GDS	36,082	40,200	42,823	48,251	54,807	60,003	59,959	55,924
Household sector savings (net financial savings, savings in physical assets and in the form of gold and silver ornaments)	22,853	24,391	24,749	27,871	32,966	38,446	39,291	43,906
Gross financial savings	11,908	12,572	14,962	16,147	20,564	22,636	23,991	31,089

[3] *https://data.worldbank.org/indicator/NY.GDS.TOTL.ZS*

Financial liabilities	3,587	3,768	3,854	4,686	7,507	7,712	7,866	8,052
Savings in physical assets	14,164	15,131	13,176	15,946	19,442	23,094	22,735	20,484
Savings in the form of gold and silver ornaments	368	456	465	465	467	427	431	384

Note: The data is for financial year ending March 31; Physical assets are those held in physical form, such as real estate, etc.
Source: MOSPI, National Accounts National Accounts Statistics, CRISIL Research

Household savings growth



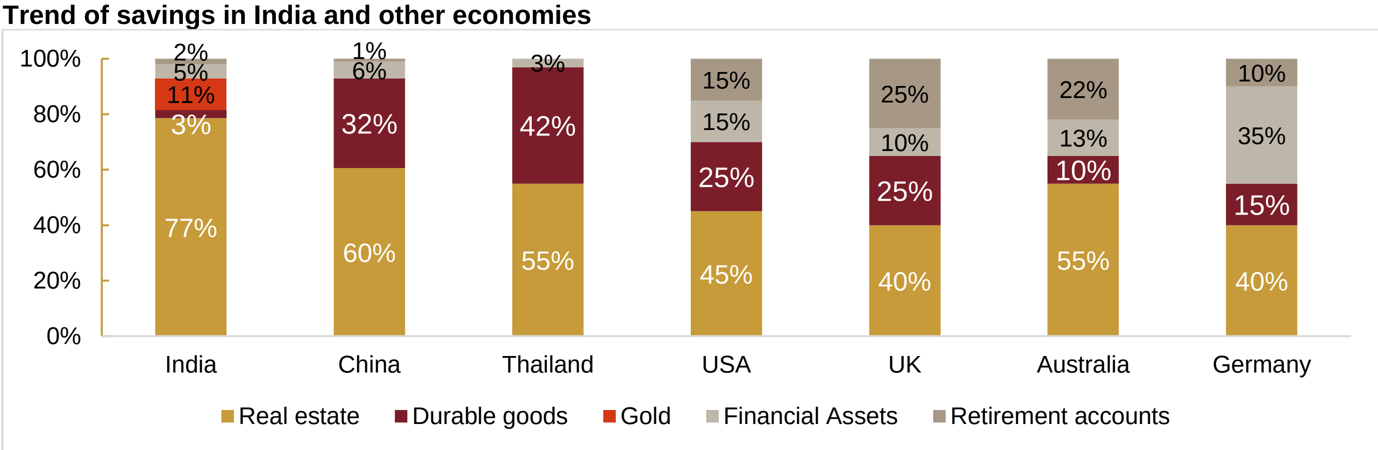
Note: The data is for financial year ending March 31, 2021
Source: MOSPI, CRISIL Research

CRISIL Research expects India to continue being a high savings economy. CRISIL Research is also sanguine on savings rate increasing in the medium-term, as households become more focused post the pandemic-induced uncertainty on creating a nest egg for the future.

Physical assets still account for majority of the savings

Unlike most other countries, where financial savings account for a significant proportion of savings, physical assets in the form or real estate, gold and silver still account for most household savings in India.

Trend of savings in India and other economies



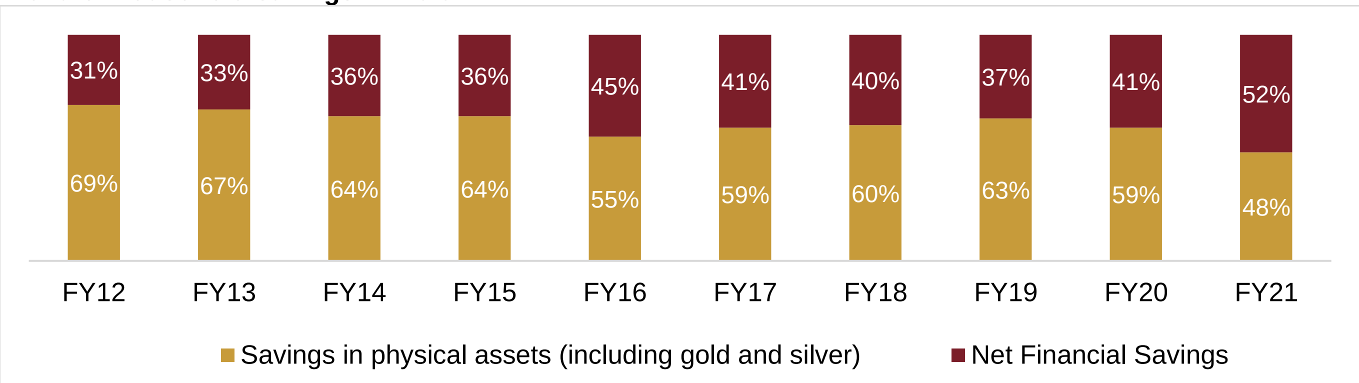
Source: Report of the Household Finance Committee[4]:July 2017, RBI, CRISIL Research

[4] *https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/HFCRA28D0415E2144A009112DD314ECF5C07.PDF*

Although households' savings in physical assets has declined to 48% in fiscal 2021 from 69% in fiscal 2012, it constitutes a substantial share in overall savings. On the other hand, the share of financial savings has witnessed an uptrend to 52% in fiscal 2021 from 31% in fiscal 2012.

With volatility in the financial markets post COVID and the prevalent lower rates of return in the fixed income products on account of accommodative stance of RBI, some proportion of savings is expected to continue to remain in the physical assets. In the long-term, with increase in financial literacy, CRISIL Research expects the share of financial assets as a proportion of net household savings to increase over the next five years, thereby boosting investments in assets such as insurance and mutual funds.

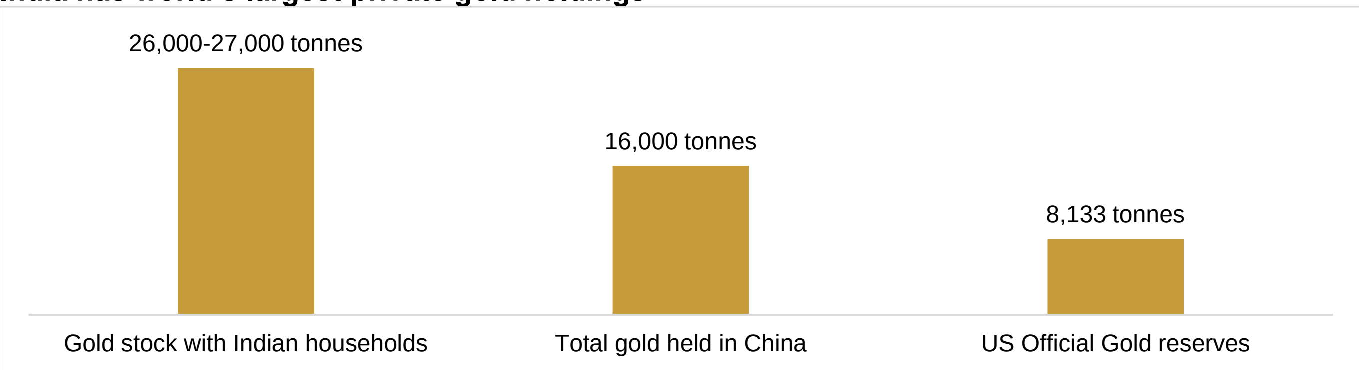
Trend of household savings in India



Note: The data is for financial year ending March 31, 2021, Source: Handbook of Statistics on Indian Economy, RBI, MOSPI, CRISIL Research

As of March 2011, Indian households had gold stock of around 19,000 to 20,000 tonnes which has increased to 27,400 tonnes as of March 2022, of which just around 7% is pledged with financiers, as per CRISIL Research estimates.

India has world's largest private gold holdings



Source: CRISIL Research estimates

As more and more households become more open to monetising their gold holdings to meet either personal or business needs and the ease of obtaining a gold loan improves, the addressable market for financiers would expand significantly. At the average market price of Rs 50,880 per 10 gram of gold in May 2022, monetising even 20% of the gold stock in the form of a loan at a 70% loan-to-value ratio ("LTV") is expected to lead to a Rs 18 trillion market opportunity for financiers.

Rural economy is becoming structurally far more resilient

At a time when the Indian economy has been severely impacted by the COVID-19 pandemic, the rural economy, which accounts for almost half of India's GDP, has been a harbinger of hope. Rural India emerged relatively unscathed from the first Covid-19 wave due to lower spread of the pandemic in these areas, agricultural activity continuing unhindered, additional support offered by the government by increasing allocation under the Mahatma Gandhi National Rural Employment Guarantee Act (MNREGA) and disbursing funds under the PM-Kisan scheme, and the relatively lower contribution of services, most badly hurt due to the pandemic, in the rural GDP. Further, higher Government procurement of food grains to support the Pradhan Mantri Garib Kalyan Anna Yojana, also spurred higher production.

The second wave of Covid-19 has had some impact in rural India, thereby hurting household balance sheets. This, along with the progress of the monsoons and sowing activity in respect of kharif crops, would influence rural incomes in the near-term.

Nevertheless, CRISIL Research believes that the rural economy is far more resilient today due to two consecutive years of good monsoon, increased spends under MNREGA and irrigation programmes, direct benefit transfer (DBT), the PM-Kisan scheme, PM Ujwala Yojana for cooking gas, PM Awas Yojana for housing, and Ayushman Bharat scheme for healthcare. To supplement this, there has been a continuous improvement in rural infrastructure such as electricity and roads. These Government initiatives have led to lesser leakages and higher incomes in the hands of the rural populace, thereby enhancing their ability and willingness to spend on discretionary products and services.

Through Direct Benefit Transfer, the government has transferred more than Rs 6.3 trillion in fiscal 2022 under 318 schemes. In the coming years as well, CRISIL Research expects DBT transfers to continue to increase at a healthy pace, as the government tightens focus on making subsidies available directly in the account of the intended beneficiaries.

The structural changes, combined with a positive macro environment, will improve rural business prospects, provide business opportunities for the banking and financial services sector and drive the long term growth of the economy.

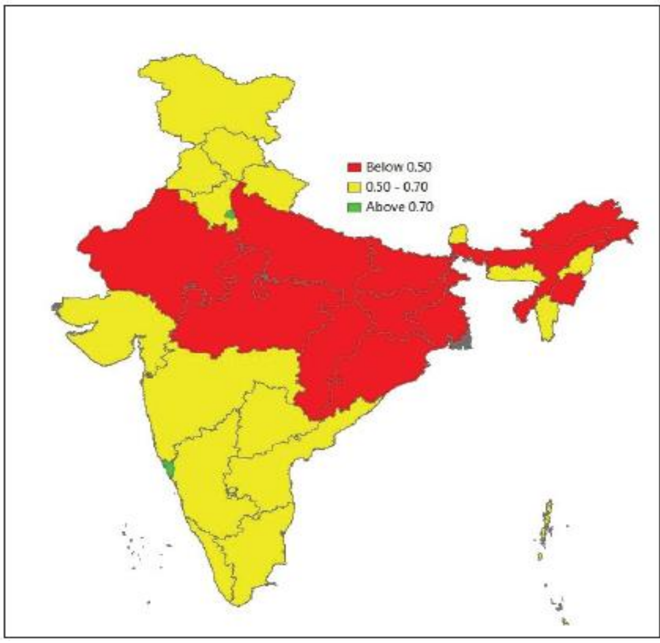
Access to bare necessities across rural areas has improved considerably over the last few years

The bare necessities index (BNI), which was included as part of the Economic Survey for 2020-21, indicates how the access to bare necessities in semi-urban and rural areas has improved considerably in the last few years, thereby enhancing the quality of life and aspirations of the populace.

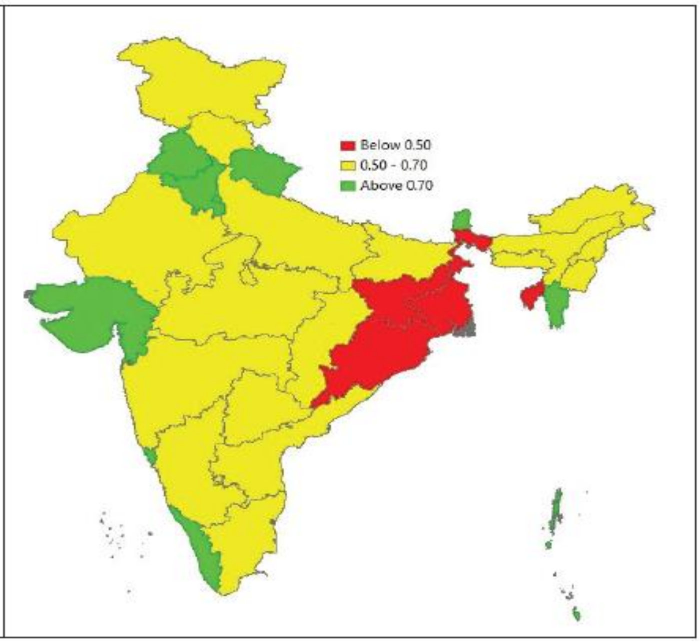
The BNI summarises 26 indicators on five dimensions viz., water, sanitation, housing, micro-environment, and other facilities. The BNI has been created for all states for 2012 and 2018 using data from two NSO rounds (69th and 76th) on drinking water, sanitation, hygiene and housing conditions in India. The BNI indicates that access to the bare necessities has improved across all States in the country in 2018 as compared to 2012. Access to bare necessities is the highest states such as Kerala, Punjab, Haryana and Gujarat while it is the lowest in Odisha, Jharkhand, West Bengal and Tripura. The improvements are widespread as they span each of the five dimensions. Furthermore, inter-state disparities in the access to bare necessities have declined in 2018 when compared to 2012 across rural and urban areas. This is because the states where the level of access to the bare necessities was low in 2012 have gained relatively more between 2012 and 2018. Access to the bare necessities has improved disproportionately more for the poorest households when compared to the richest households across rural and urban areas.

The below graphs indicate the state-wise values of BNI in 2012 and 2018 for India as a whole as well as urban and rural areas. A higher value indicates better access to bare necessities in a state ad vice-versa. The three colours, green, yellow and red, used in the maps show the level of a state in providing access to bare necessities to its households. Green (above 0.70) indicates high level, followed by yellow (0.50 to 0.70), which indicates medium level. In contrast, red (below 0.50) indicates very low level of access. The difference in colours in a map indicate the regional variation in the access to bare necessities for the households.

Pan-India BNI (Urban + Rural in 2012)



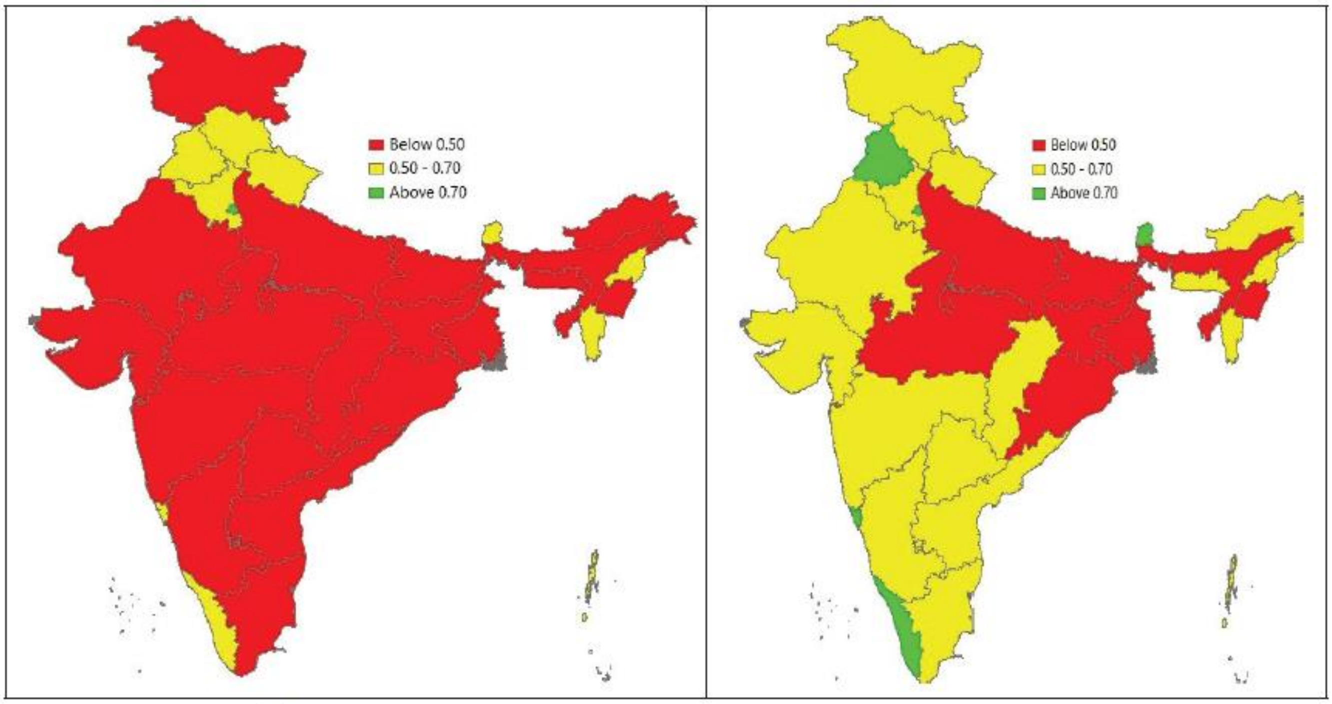
Pan-India BNI (Urban + Rural in 2018)



Source: Economic Survey 2020-21

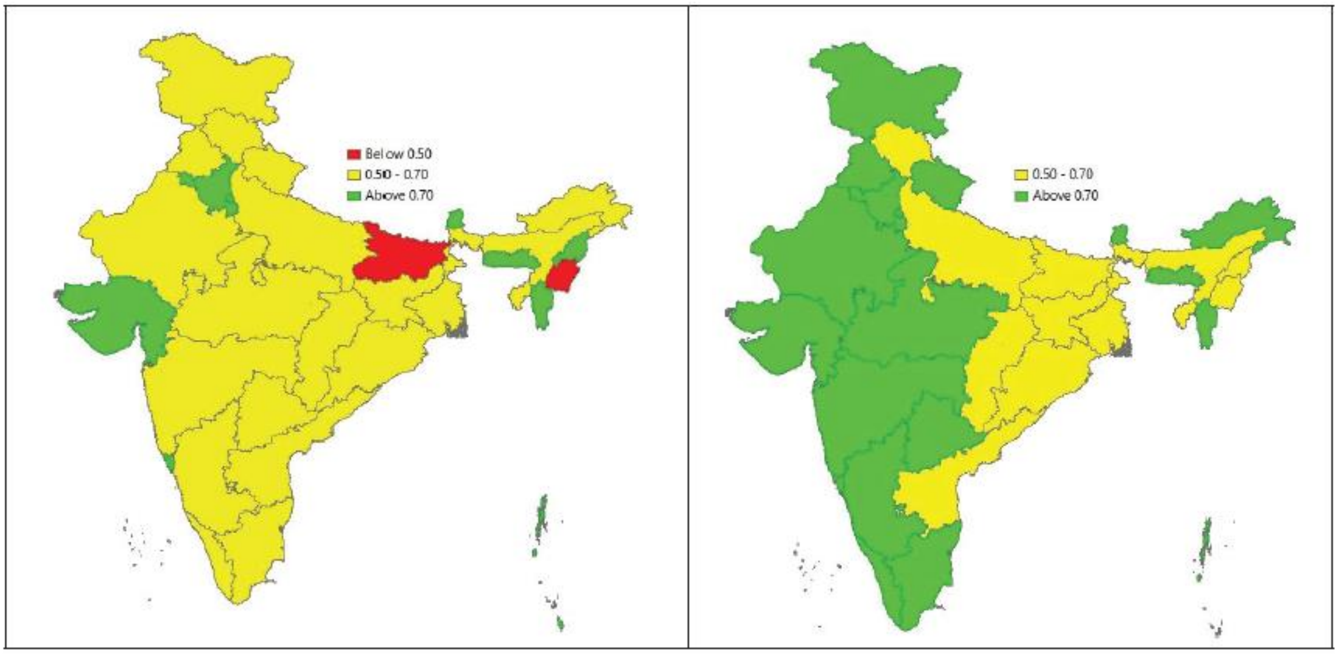
BNI for Rural India (2012)

BNI for Rural India (2018)



Source: Economic Survey 2020-21

BNI for Urban India (2012) **BNI for Urban India (2018)**



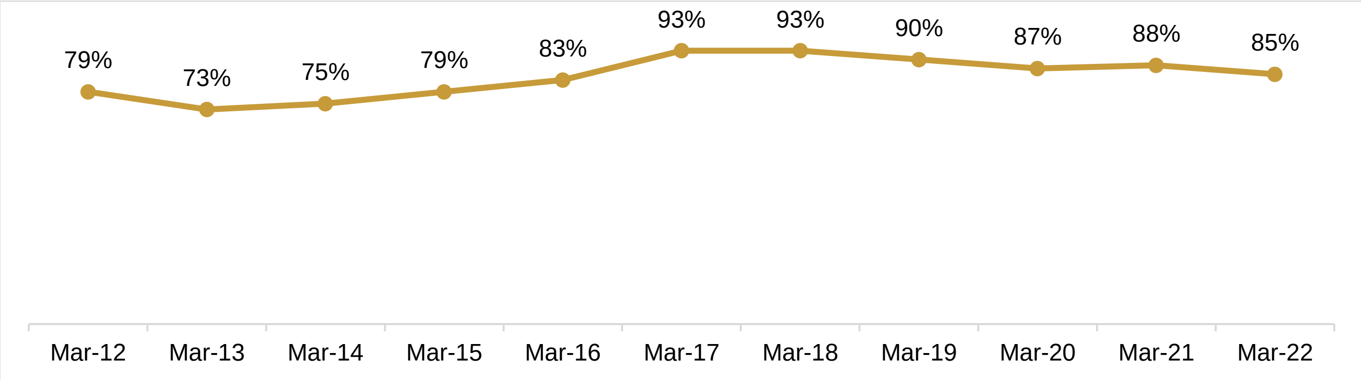
Source: Economic Survey 2020-21

Digitisation: Catalyst for the next growth cycle

Technology is expected to play a pivotal role in taking the financial sector to the next level of growth, by helping surmount the challenges stemming from India's vast geography, which makes physical footprints in smaller locations commercially unviable. Technology is conducive for India, considering its demographic structure where the median age is less than 30 years. The young population is tech savvy and at ease with using it to conduct the entire gamut of financial transactions. With increasing smartphone penetration and faster data speeds, consumers are now encouraging digitisation as they find it more convenient. Digitisation will help improve efficiency and optimise cost. Players with better mobile and digital platforms will draw more customers and emerge as winners in the long term.

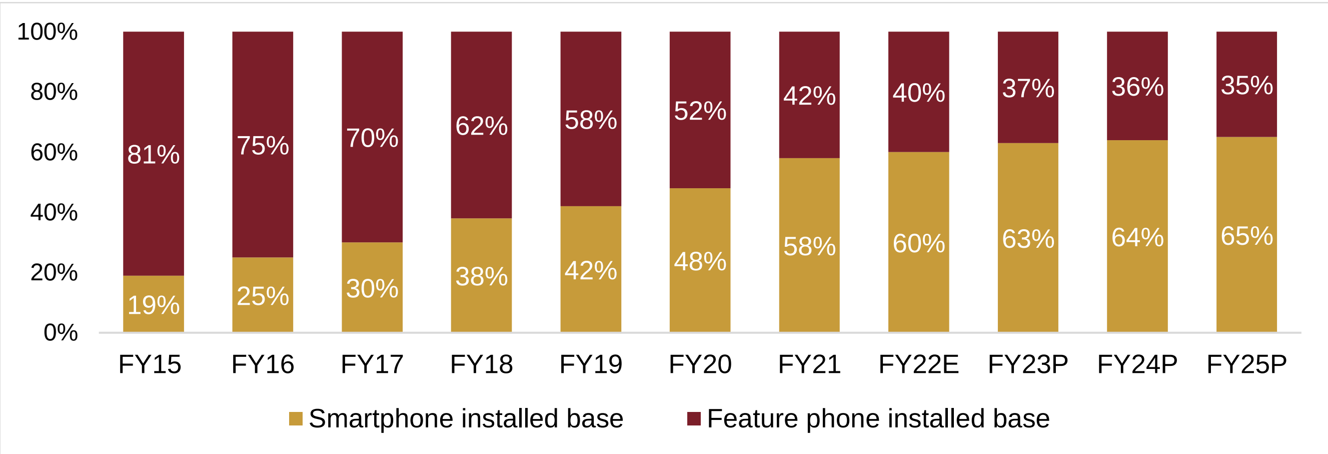
Mobile penetration: Higher mobile penetration, improved connectivity and faster and cheaper data speed, supported by Aadhaar and bank account penetration have led India to shift from being a cash-dominated economy to a digital one.

Tele-density in India



Source: TRAI, CRISIL Research

Data-savvy and younger users to drive adoption of smartphones



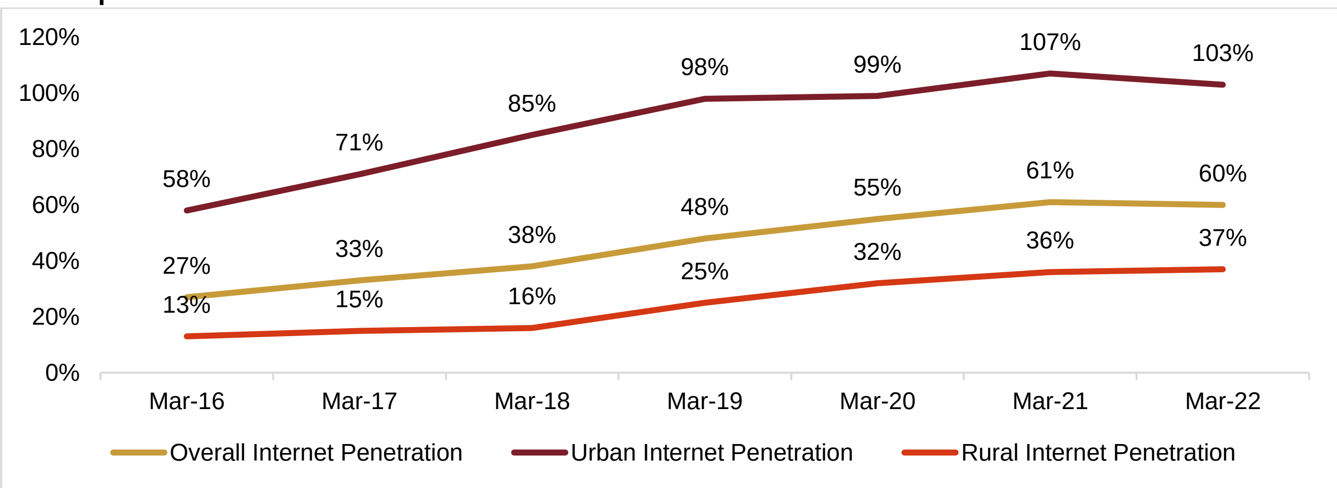
Note: P: Projected, E: estimated if actual data is not available
Source: CRISIL Research

Internet penetration: India has witnessed a dramatic surge in internet users over the past few years with internet penetration as a percentage of total population touching ~60% as of fiscal 2022 compared to less than 20% in fiscal 2015. This growth has largely been fuelled by the availability of smartphones at cheaper price points and availability of 4G connectivity at affordable prices.

CRISIL Research expects the total number of internet subscribers in the country to reach ~910-915 million by fiscal 2024 from 825 million as of March 2022, resulting in ~65% internet penetration. By 2026, complete transition of 2G and 3G data services to 4G is expected. This can be attributed to increased demand for data, competitive pricing of 4G services and availability of affordable handsets.

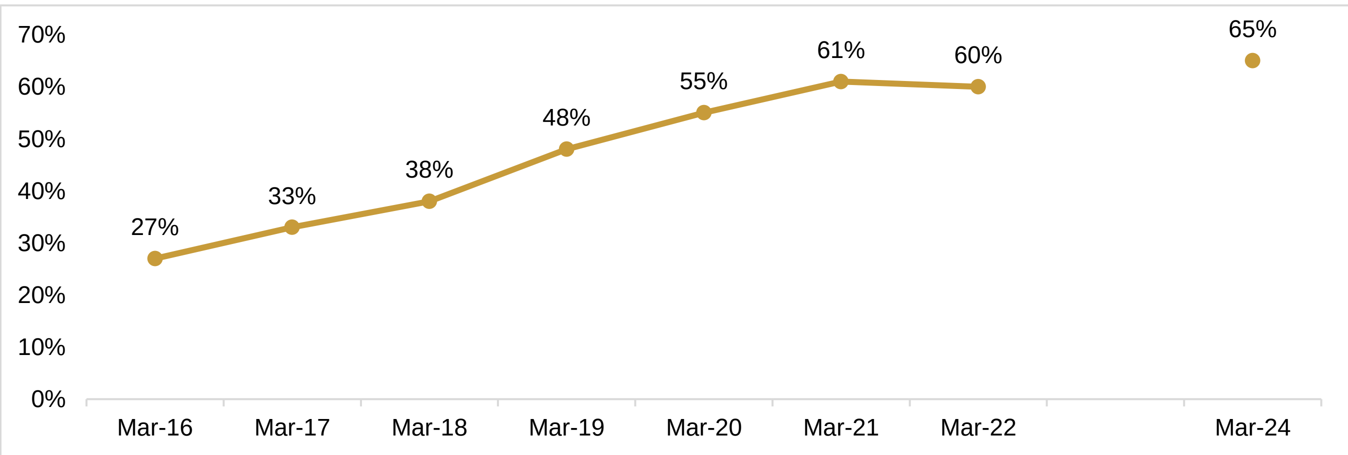
While internet penetration in urban areas have crossed 100%, in rural areas, the penetration is still below 40%. Nonetheless, the number of data subscribers in rural areas have almost tripled to 332 million subscribers as of March 2022 compared to 111 million subscribers as of March 2016 (Source: TRAI).

Internet penetration continues to increase



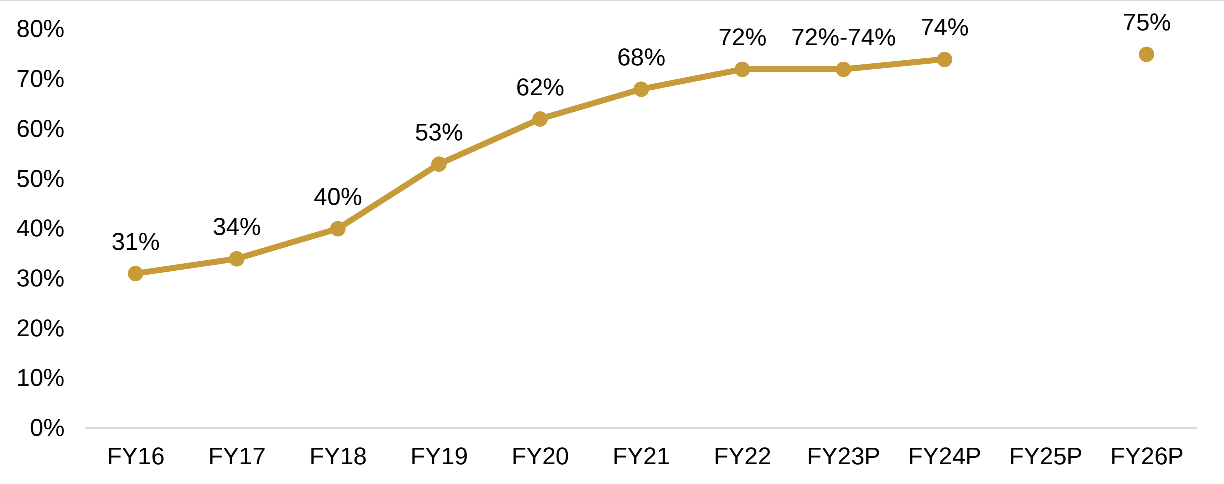
Source: TRAI, CRISIL Research

Overall Internet penetration to reach 65% by fiscal 2024



Note: P- Projected
Source: TRAI, CRISIL Research

Data subscribers as a proportion of wireless subscribers to increase significantly through FY25



Note: P: Projected

Source: TRAI, CRISIL Research

Rise in 4G penetration and smartphone usage

The digital revolution has paved the way for digital payments. India had 1,142 million wireless subscribers as of March 31, 2022, and the number is growing at a steady pace every year. The reach of mobile network, internet and electricity is also expanding the digital payments footprint to remote areas. This is likely to increase the number of digital payment transactions. However, in semi urban and rural areas, internet, 4G and smartphone penetration is still lower compared to urban areas

All-India mobile and data subscriber base

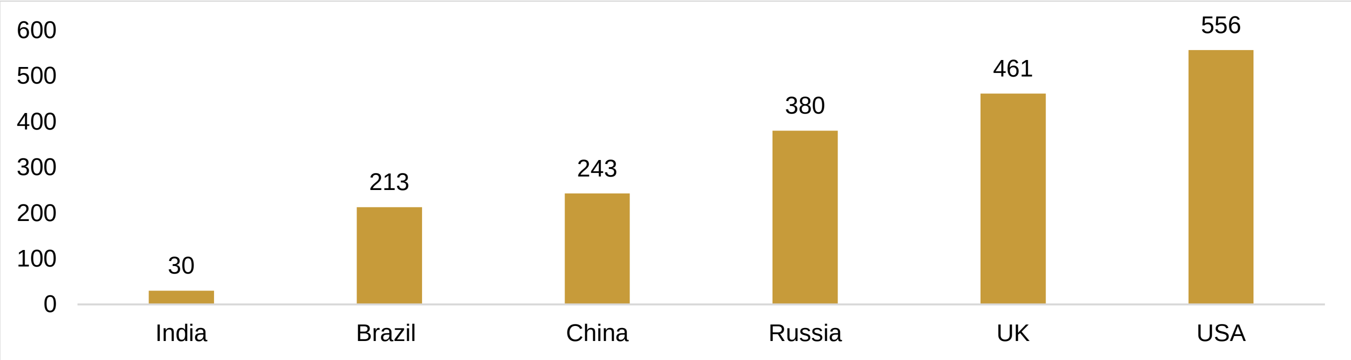
	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23P	FY26P
Wireless subscribers (million)	1034	1170	1183	1162	1157	1181	1142	1165	1270
Data subscribers (million)	322	401	473	615	720	756	825	832	953
Data subscribers as a proportion of wireless subscribers	31%	34%	40%	53%	62%	64%	72%	72%	75%
4G data subscribers (million)	8	131	287	478	645	719	762	809	900
4G data subscribers proportion	2%	33%	61%	78%	90%	95%	92%	97%	94%

Note: P: Projected
Source: TRAI, CRISIL Research

Wireless data consumption in India has grown ~12 times in the past five fiscals at a CAGR of ~65%. The proportion of data subscribers is hence expected to rise to ~75% in fiscal 2026 from ~62% at FY 20. India's 4G data rates are among the lowest in the world. So, a combination of affordable handsets, growing consumer preference for data on the go and affordable data tariffs are set to accelerate the adoption of wireless internet in India, leading to a 4G data subscriber proportion at ~100%.

Digital payments and per capita transactions in India are among the lowest compared with similar countries. The government has taken multiple initiatives to give a boost to digitalisation in the country. This includes biometric identification of all Indian citizens through the Aadhaar programme, financial inclusion through the 'Jan Dhan Yojana', launch of Aadhaar-enabled payment systems, and push to online tax filings. UPI, which is based on the immediate payment service or IMPS platform, allows a user to transfer money from one bank account to another bank account instantly, and is seen as the next big leap in digital payments. Recent initiatives aimed at addressing the structural issues around lending requirement including GST filings, government launched UPI 2.0.

Average number of non-cash payments transactions per capita, per annum (CY 2020)



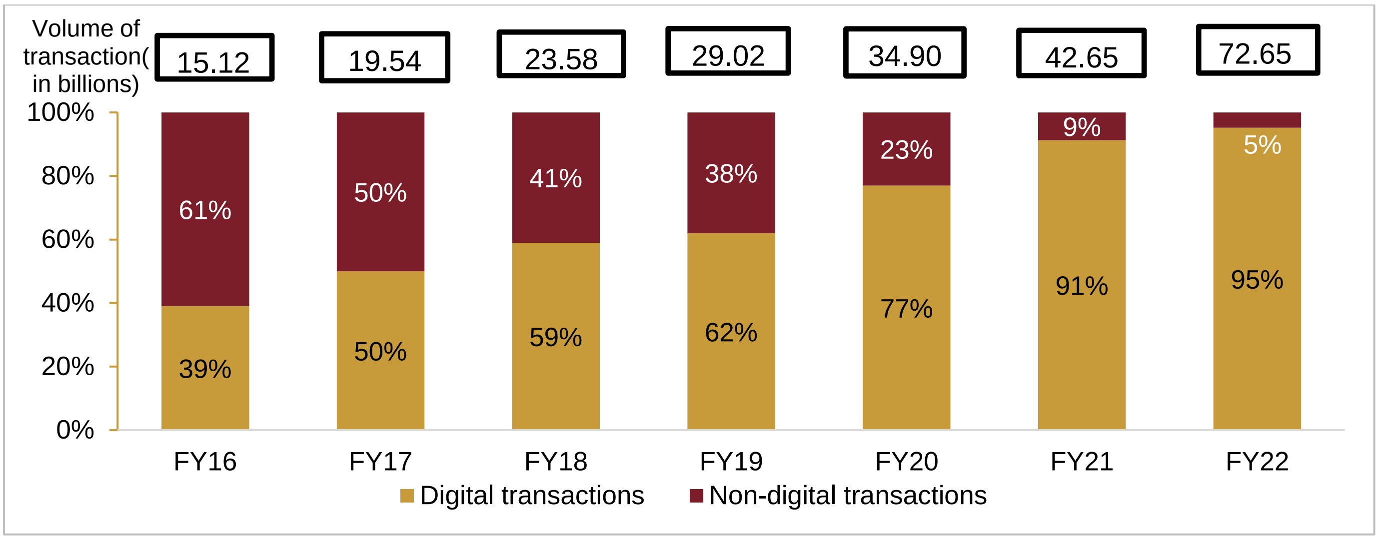
Source: Bank of International Settlements, CRISIL Research

Consumers are increasingly finding transacting through mobile convenient. CRISIL Research expects the share of mobile banking and prepaid payment instruments to increase dramatically over the coming years. In addition, CRISIL Research expects improved data connectivity, low digital payment penetration and proactive government measures to drive digitalisation in the country, transforming it into a cashless economy.

Digital payments have witnessed substantial growth

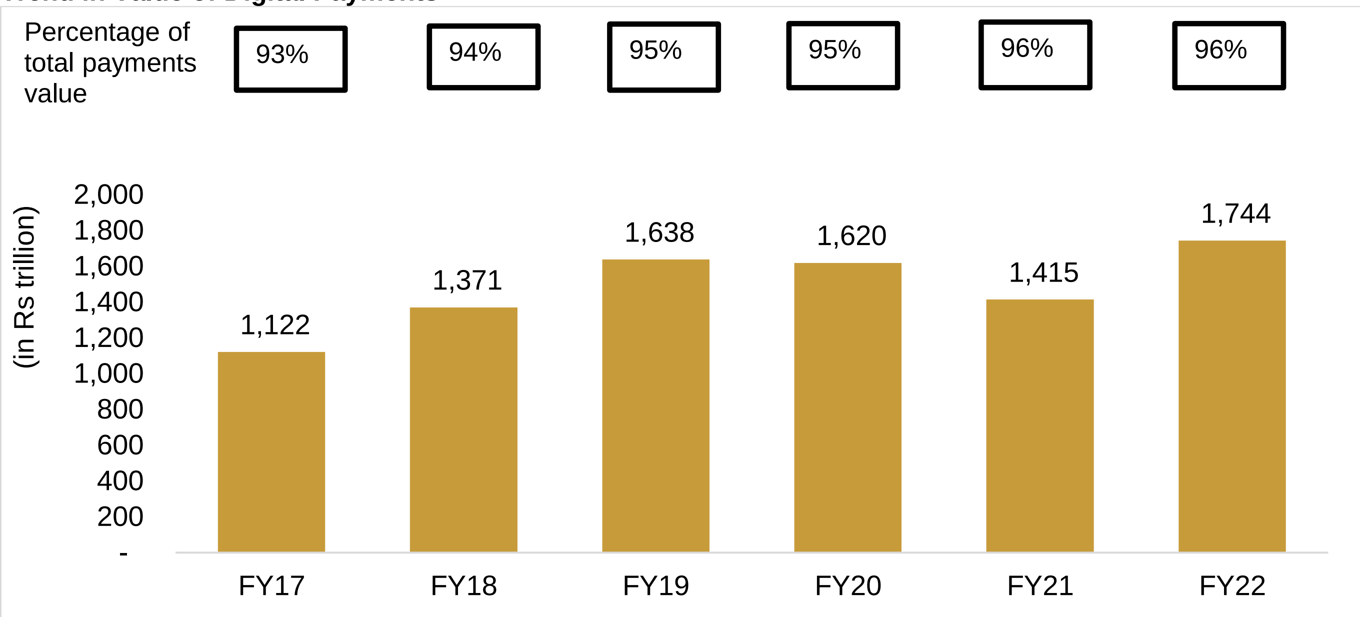
Total digital payments in India have witnessed significant growth over the past few years. Between fiscal 2016 and 2022, the volume of digital payments transactions has increased from 6.3 billion to 69.2 billion, causing its share in overall payment transactions to increase from 39% in fiscal 2016 to 95% in fiscal 2022. During the same period, value of digital transactions has increased from Rs. 1,122 trillion in fiscal 2017 to Rs. 1,744 trillion in fiscal 2022.

Trend in volume of digital payments



Note: Digital Payments includes RTGS payments, Credit transfers (AePS, APBS, ECS Cr, IMPS, NACH, NEFT, UPI), Debit Transfers (BHIM, ECS Dr, NACH Dr, NETC), Card Payments (Debit and Credit Cards) and Prepaid Payments Instruments
Source: RBI, CRISIL Research

Trend in Value of Digital Payments



Note: Digital Payments includes RTGS payments, Credit transfers (AePS, APBS, ECS Cr, IMPS, NACH, NEFT, UPI), Debit Transfers (BHIM, ECS Dr, NACH Dr, NETC), Card Payments (Debit and Credit Cards) and Prepaid Payments Instruments
Source: RBI, CRISIL Research

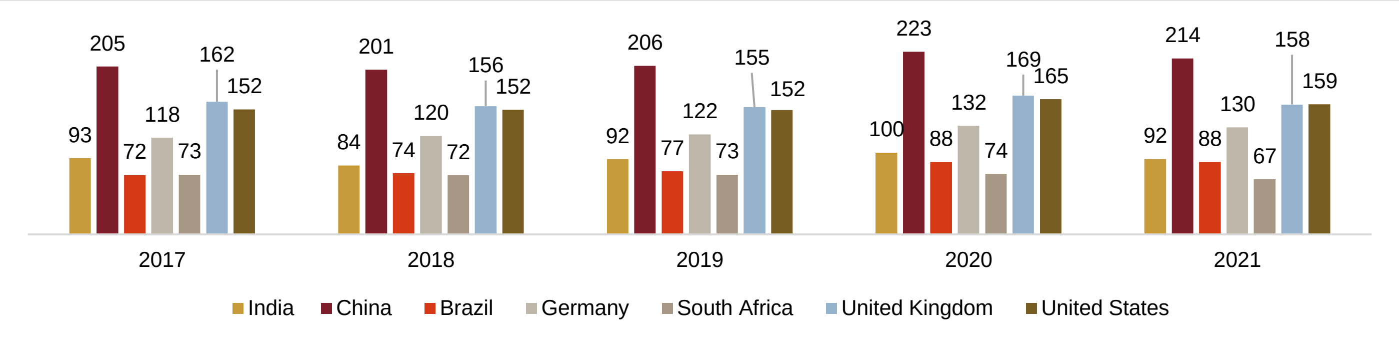
Financial Inclusion

Credit penetration is lower in India compared to other countries

The COVID-19 pandemic has spread across the world, and India is no exception. The lockdown of nearly 1.4 billion people and a large number of businesses led to disruption and dislocation on a scale never imagined. It slammed the brakes on economic activity and caused enormous human suffering.

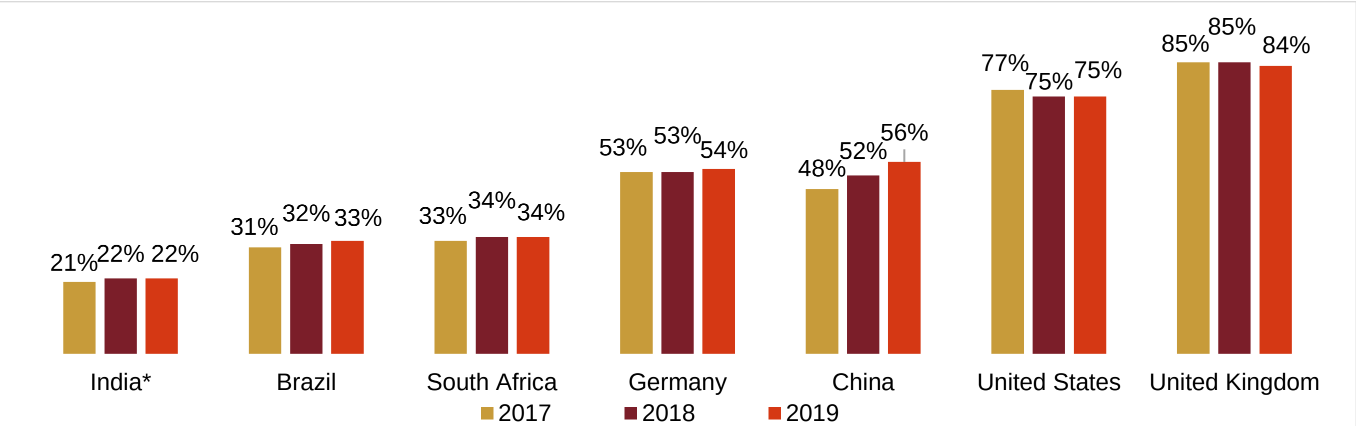
In these times of crisis, financial inclusion becomes more imperative than ever for vulnerable households and businesses to navigate the crises and recover after the pandemic. In terms of the credit to GDP ratio, India has a low credit penetration compared with other developing countries, such as China indicating that the existing gap needs to be bridged. Similarly, in terms of credit to households as a proportion of GDP as well, India lags other markets, with retail credit hovering at around 22% of GDP as of fiscal 2020.

Credit to GDP ratio (%) CY2021



Note: Data is represented for calendar years for all countries except India. For India, numbers are for fiscal year 2021.
Source: Bank of International Settlements[5], CRISIL Research

Household Credit to GDP ratio (2017-2019)



*Note: For countries except India, data is represented for calendar years. *For India, data represented is for FY18, FY19 and FY20*
Source: Bank of International Settlements, CRISIL Research

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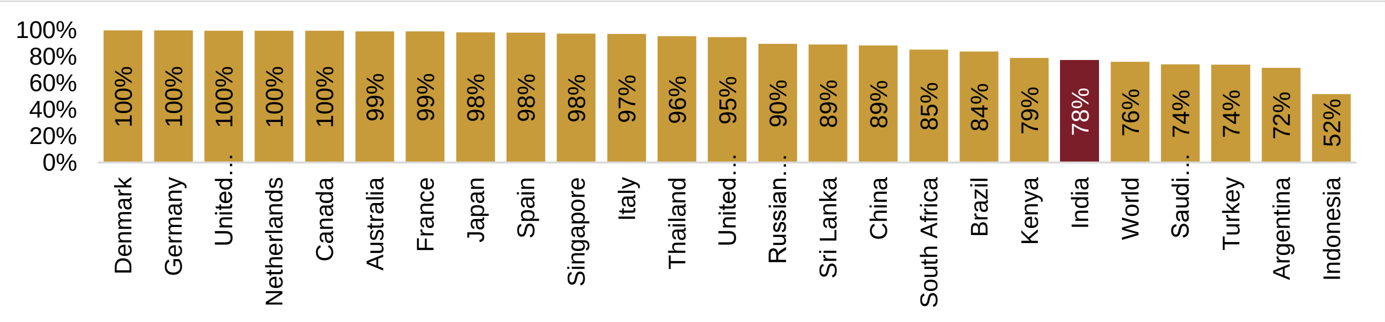
[5] *https://www.bis.org/statistics/c_gaps.htm?m=6_380_670*

Financial Inclusion on a fast path in India

Overall literacy in India is at 77.7% as per the results of recent NSSO survey conducted from July 2017 to June 2018 which is still below the world literacy rate of 86.5%. However, according to the National Financial Literacy and Inclusion Survey (NCFE-FLIS) 2019, only 27% of Indian population is financially literate indicating huge gap and potential for financial services industry. The survey defines financial literacy as combination of awareness, knowledge, skill, attitude and behaviour necessary to make sound financial decisions and ultimately achieve individual financial wellbeing.

According to the World Bank's Global Findex Database 2021, the global average of adult population with an account opened with a bank, financial institution or mobile money provider, was approximately 69% in calendar year 2021. India's financial inclusion has improved significantly over calendar years 2014 to 2021 as adult population with bank accounts increased from 53% to 78% (Source: Global Findex Database) due to the Indian government's concentrated efforts to promote financial inclusion and the proliferation of supporting institutions.

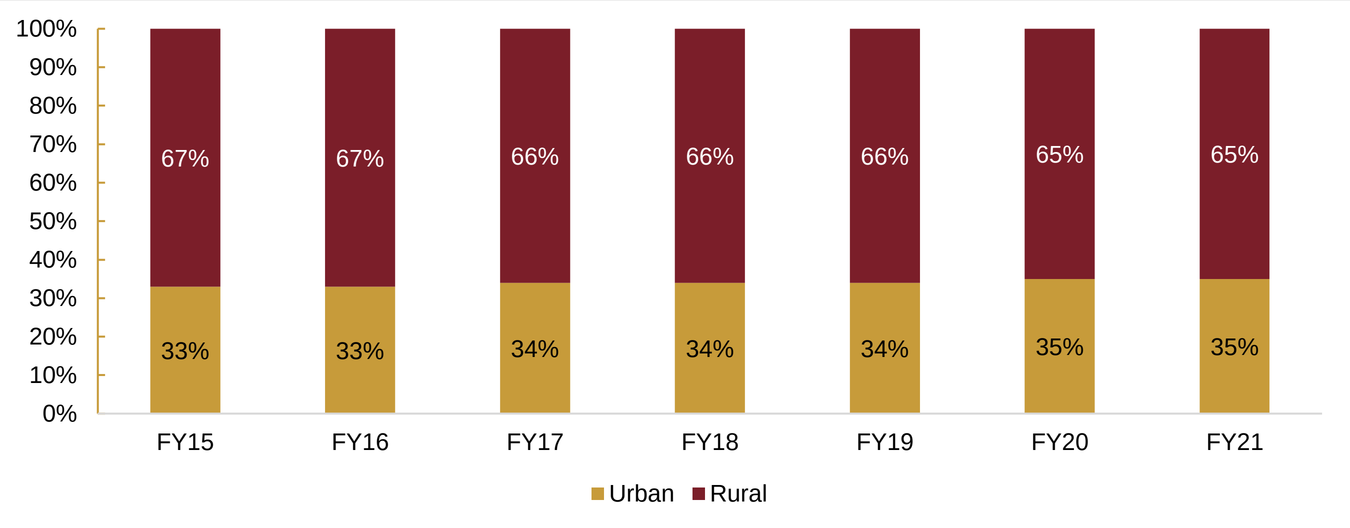
Adult population with a bank account (%): India vis-à-vis other countries



Note: 1. Global Findex data for India excludes northeast states, remote islands and selected districts. 2. Account penetration is for the population within the age group of 15+, Source: World Bank - The Global Findex Database 2021, CRISIL Research

The low levels of adults with bank accounts in comparison with various countries can be further explained by the large number of rural households in the country, which account for nearly two-thirds of the total households in the country. The shift in households towards urban regions is taking place albeit at a very slow pace.

Two-thirds of total households are in rural India



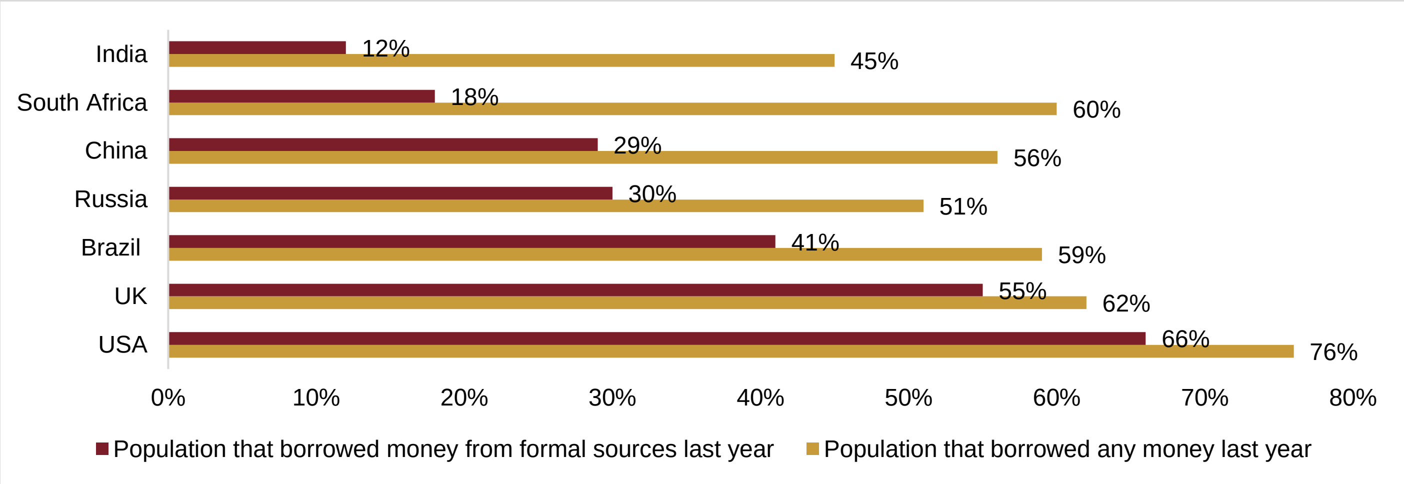
Source: World Bank; Census; CRISIL Research

Although the majority of Indian households are located in the rural region, the banking infrastructure in these regions is relatively inferior and, thus, there is a gap in the supply and demand of financial services in the backward regions of the country, which is a pocket of opportunity for the financial services sector.

Financial exclusion is widely prevalent in countries, such as India, due to poverty and low income, financial illiteracy, high transaction costs, and lack of infrastructure (primarily information technology). Consequently, a significant proportion of the population still lacks access to formal banking facilities. According to NABARD All India Rural Financial Inclusion Survey 2016-17, 40% loans were reported as taken from non-institutional investors or informal channels like relative and friends, money lenders and local landlords.

According to the World Bank's Global Findex Database 2021, only 12% of the Indian population borrowed money through a formal channel like financial institutions which is very low compared to other developed and developing countries. The population that borrowed money through formal channel was 8% as of 2017 (Source: World Bank-The Global Findex Database 2017).

Only 12% of India's population borrowed money from formal sources (CY2021)

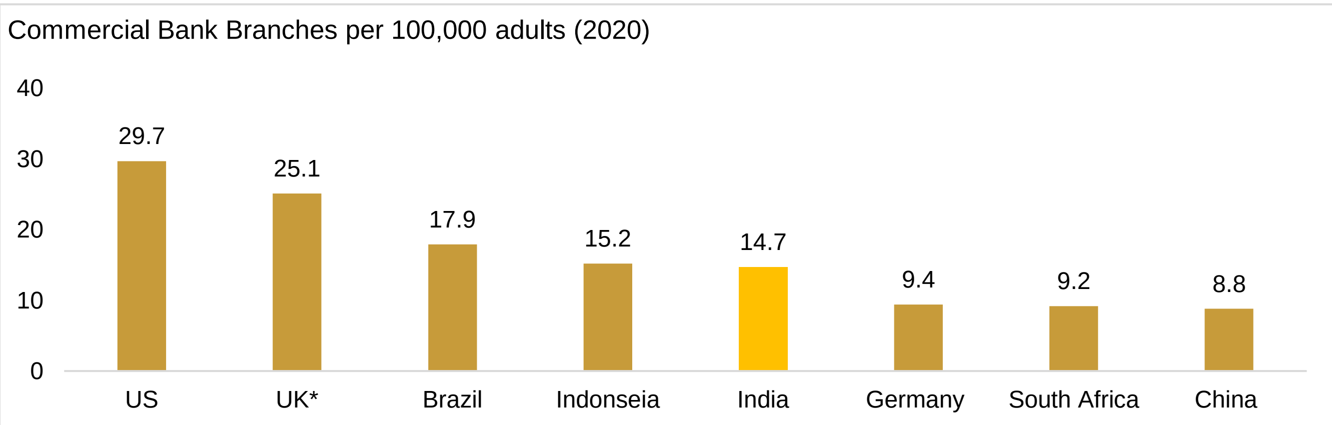


Note: 1. Global Findex data for India excludes northeast states, remote islands and selected districts. 2. Data is for the population within the age group of 15+
3. Money borrowed from formal sources includes money borrowed from Banks, NBFCs and usage of credit card
Source: World Bank - The Global Findex Database 2021, CRISIL Research

To tackle financial exclusion, the Indian government introduced the PMJDY, a scheme that facilitates opening bank accounts by the unbanked. However, the effective use of these new accounts, increase in the number of transactions in these accounts and availability of credit remain key challenges, which need to be effectively addressed as borrowings from the formal sources still remains low.

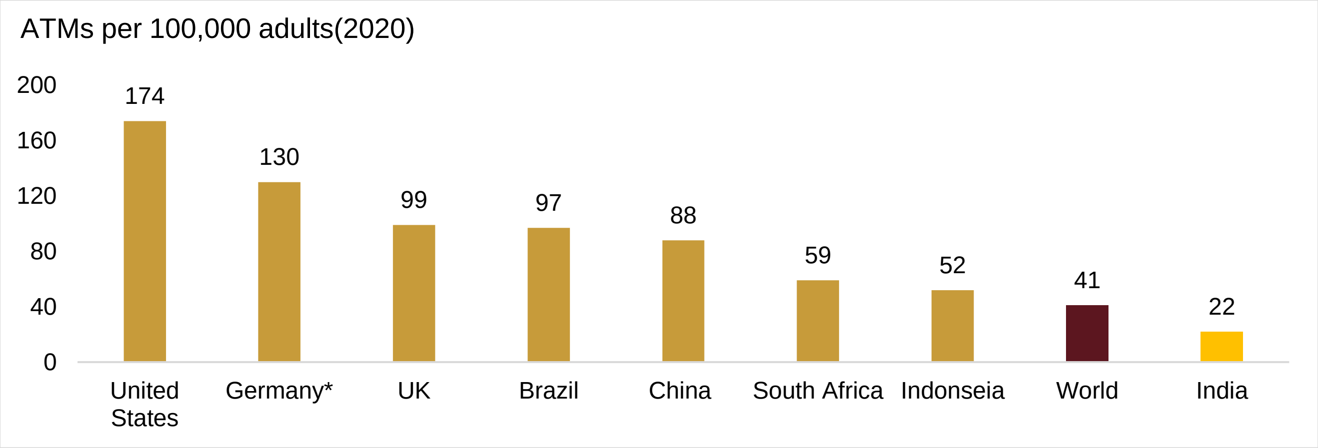
India is one of the countries with lower commercial bank branches and ATM penetration indicating huge room for financial inclusion and banking services penetration. As of calendar year 2020, India has 14.7 branches and 22 ATMs for one lakh adults according to World Bank data which is relatively lower than other developing and developed countries.

Commercial bank branch penetration across the world (CY2020)



Note: (*) – UK data is as of 2013 calendar year
Source: World Bank, RBI, CRISIL Research

ATM penetration across the world (CY2020)



*Note: * Data for 2019*

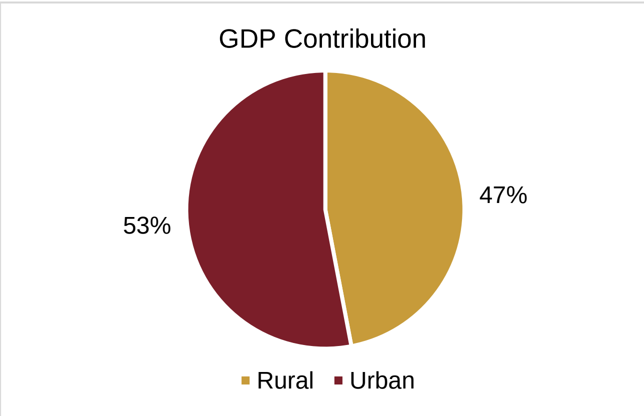
Source: Company Reports, IMF, World Bank, BIS, RBI, House of Commons Library UK, European Association of Secured Transactions (EAST), CRISIL Research

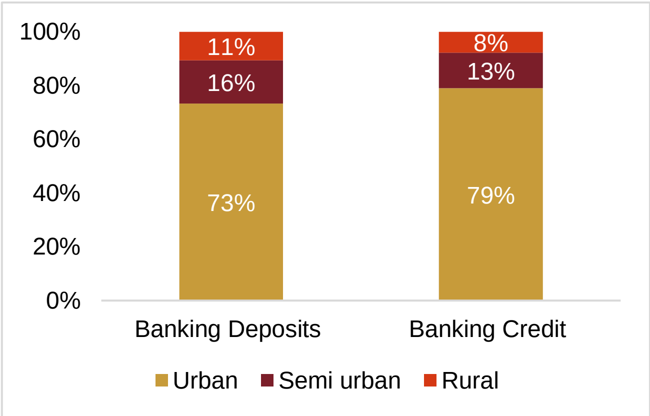
Rural India accounts for about half of GDP, but only about 8% of total credit and 11% of total deposits

According to Census 2011, there are about 640,000 villages in India, which are inhabited by about 893 million people, comprising about 65% of the country's population as of CY2021. About 47% of India's GDP comes from rural areas. The share of total credit outstanding is about 8% in rural areas and 92% in urban areas as of March 31, 2022. The massive divergence in the rural areas' share of India's GDP and banking credit services compared with urban areas is an indicator of the extremely low penetration of banks in rural areas.

The chart below shows the percentage of GDP contribution and credit outstanding in rural and urban areas:

Low share of banking credit and deposit indicates lower penetration in rural areas (as of March 2022)



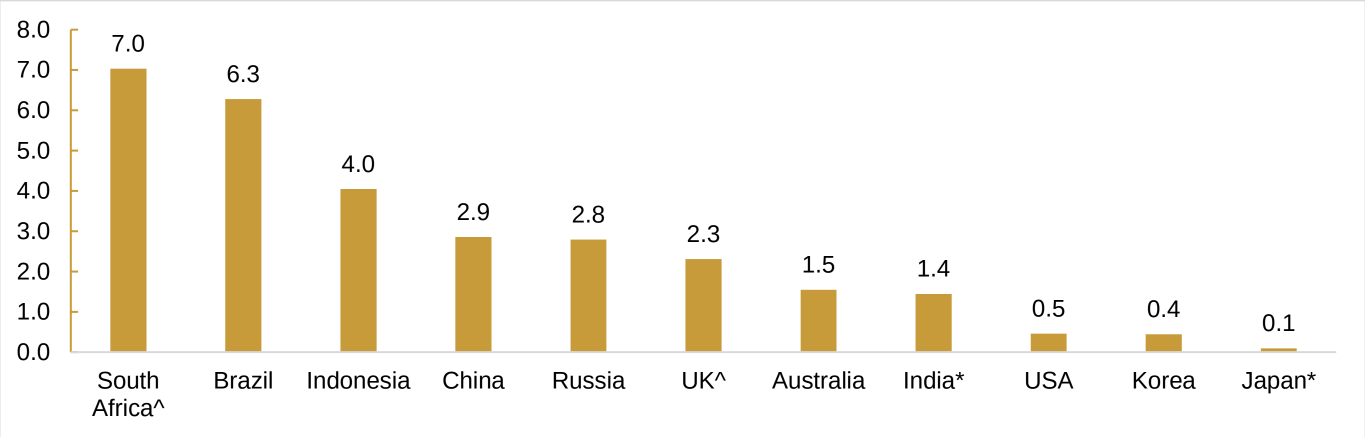


Source: CSO; RBI; CRISIL Research estimates (for GDP contribution as per 2017)

As rural areas in India have lower financial inclusion compared with urban areas and there is less competition for banking services in rural areas compared with urban areas, this presents significant growth opportunities in rural areas.

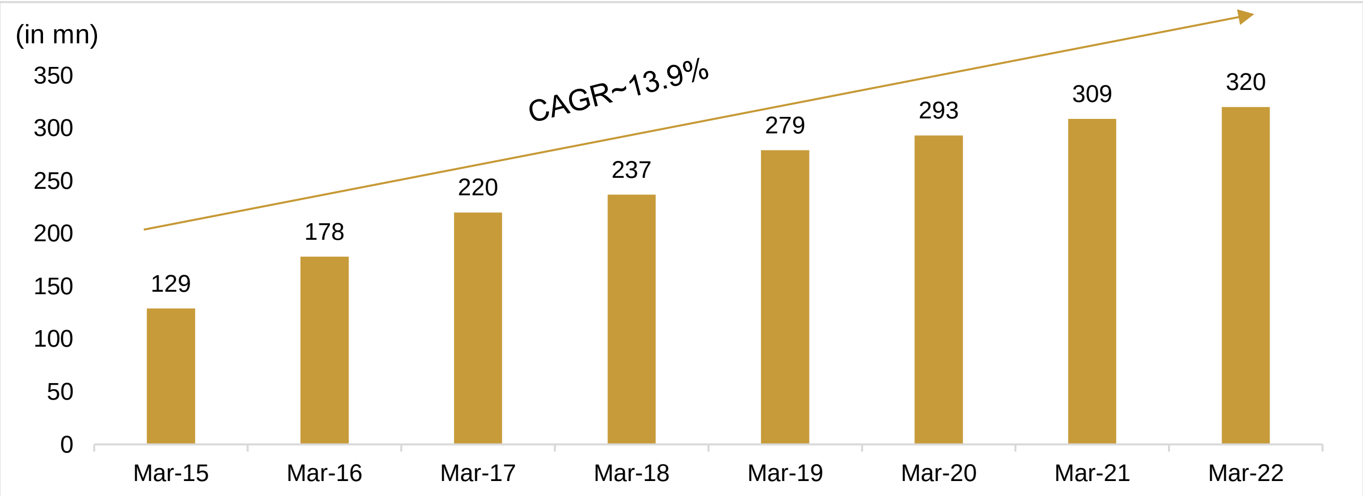
India's ATM withdrawal to Cash-in-circulation ratio lies behind other countries indicating lower debit card penetration is in the country. However, with initiatives like PMJDY focussed towards increasing financial penetration and inclusion, the government has been attempting to change the situation. Under PMJDY, the beneficiaries have been issued RuPay debit cards which has also been a key enabler from rural participation in financial system. As of March 31, 2022, 320 million RuPay debit cards have been issued to 465 million PMJDY beneficiaries. Out of these, 67% of the beneficiaries belong to rural and semi-urban areas.

ATM withdrawal to CIC (Cash in circulation) ratio



Note: (*) Data as of end of March 2020 is used for CIC and data for 2019 is used for ATM withdrawals, (^) Data as of end of February of next calendar year is used for CIC data for 2019 is used for ATM withdrawals
Source: Bank of International Settlements, CRISIL Research

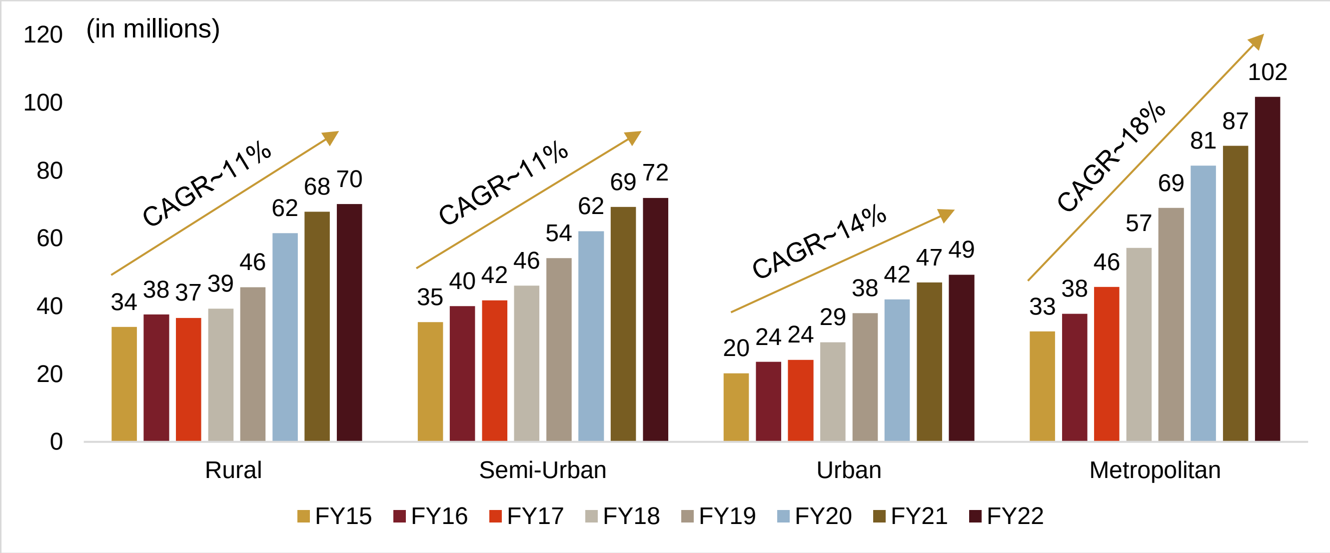
Number of RuPay debit cards issues under PMJDY



Source: PMJDY, CRISIL Research

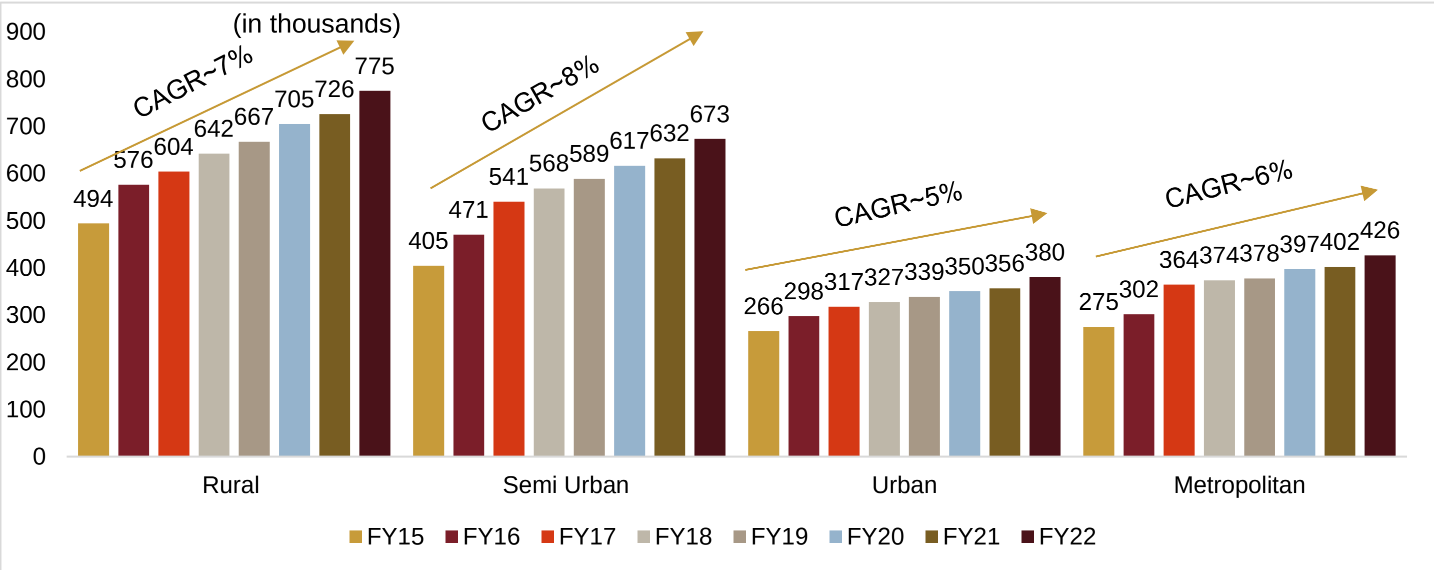
The number of bank credit accounts in rural areas grew at a CAGR of 11% between the end of Fiscal 2015 and the end of Fiscal 2022 and the number of bank deposit accounts grew at a CAGR of 7% between the end of Fiscal 2015 and the end of Fiscal 2022. However, with payments bank increasing their reach and expanding into rural areas and increasing financial awareness, faster growth in rural areas can be expected in the future given the huge untapped potential. Between the end of Fiscal 2015 and the end of Fiscal 2022, the number of credit accounts in semi-urban areas grew at a CAGR of 11% and between the end of Fiscal 2015 and the end of Fiscal 2022, the number of deposit accounts grew at a CAGR of 8%. Between the end of Fiscal 2015 and Fiscal 2022, the number of credit accounts in urban areas grew at a CAGR of 14% and between the end of Fiscal 2015 and the end of Fiscal 2022, the number of deposit accounts grew at a CAGR of 5%.

Bank credit accounts in rural, semi-urban and urban areas (FY22)



Note: Data represents only bank credit accounts
Source: RBI; CRISIL Research

Bank deposit accounts in rural, semi-urban and urban areas (FY22)

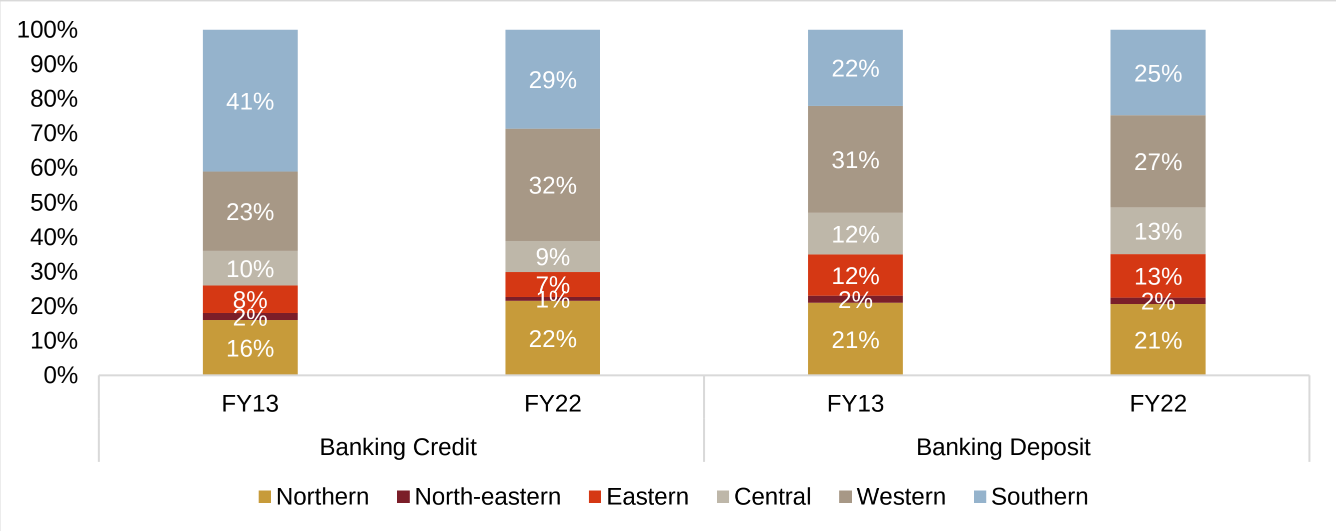


Note: Data represents only bank deposit accounts
Source: RBI; CRISIL Research

Region-wise asymmetry: Central and eastern regions have a lower share in total bank credit and deposits

Bank credit and deposits are predominantly concentrated in the southern and western regions, whereas they have been especially low in the north-eastern and eastern regions. Deposit penetration in the southern region has increased over the past eight fiscal years by 3%.

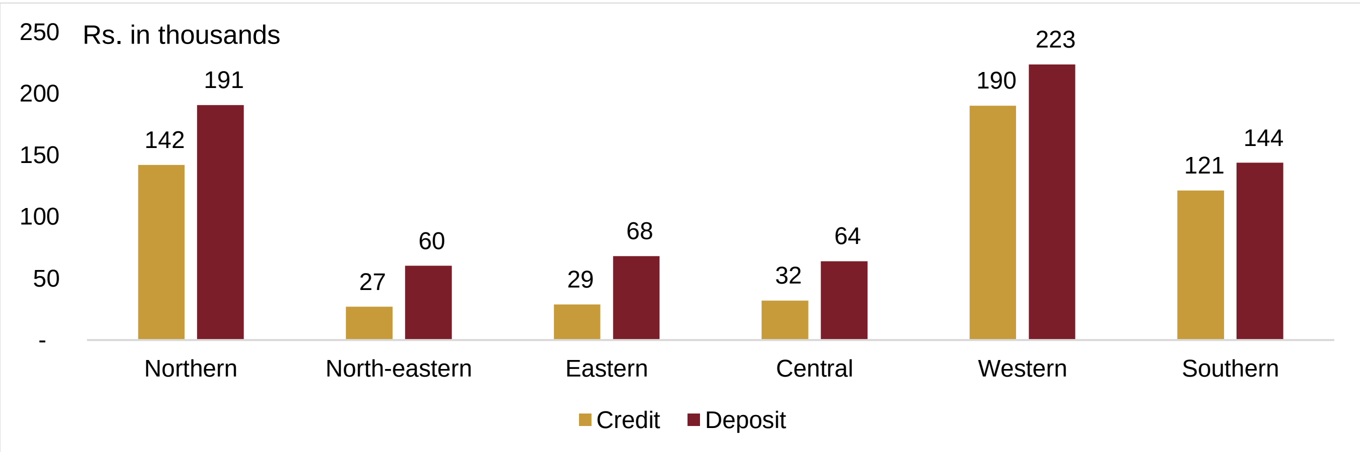
Region-wise share of banking credit and total deposits



Note: The percentages are as of the end of the fiscal year indicated.
Source: RBI; CRISIL Research

Bank credit per capita in the north-east is the lowest and is nearly four times lower than in the south and west. Low per-capita credit as well as deposits in eastern and north-eastern regions compared with other regions implies low penetration of banks in these areas. This provides an opportunity for all lending and deposit accepting institutions to expand in these regions and expand their reach in specific areas around them. In terms of deposits, the southern region is moderately penetrated compared with the northern and western regions, leaving a lot of headroom for growth for the players to capitalise on.

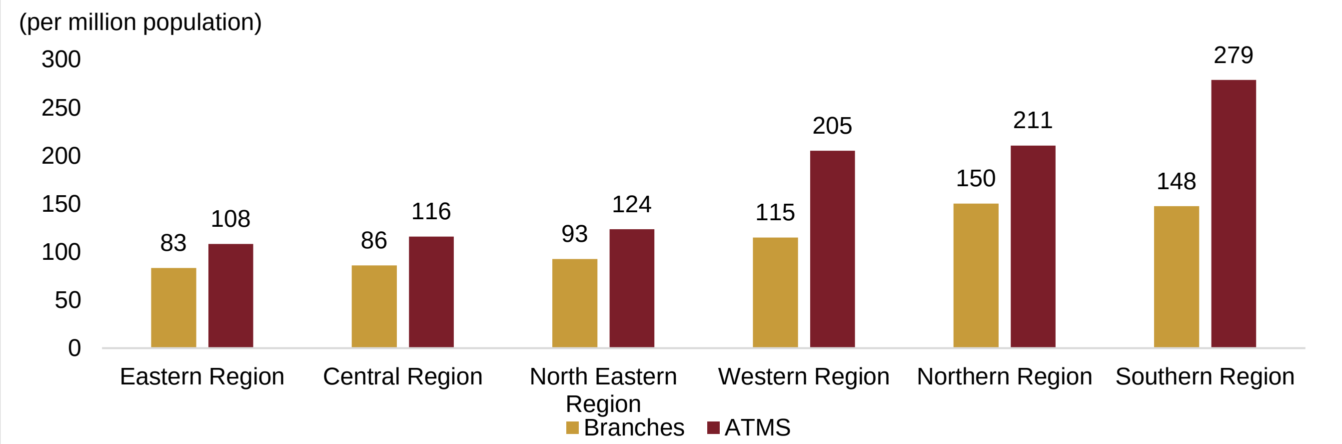
Region-wise per capita* banking credit and deposits as of the end of FY22 of scheduled commercial banks



*Note: Population as of FY21 according to CRISIL estimates, *Region-wise per capita banking credit is calculated as Banking credit divided by population, *Region-wise per capita banking deposit is calculated as Banking deposit divided by population*
States are divided into regions according to RBI nomenclature as follows:
Northern: Punjab, Haryana, Jammu and Kashmir, Delhi, Chandigarh, Ladakh, Rajasthan
North-eastern: Arunachal Pradesh, Assam, Meghalaya, Manipur, Mizoram, Nagaland, Tripura
Eastern: Odisha, Bihar, Jharkhand, West Bengal, Andaman & Nicobar Island, Sikkim
Central: Madhya Pradesh, Chhattisgarh, Uttar Pradesh, Uttarakhand
Western: Maharashtra, Gujarat, Goa, Dadra and Nagar Haveli, Daman and Diu
Southern: Andhra Pradesh, Karnataka, Kerala, Tamil Nadu, Lakshadweep, Puducherry, Telangana
Andhra Pradesh and Telangana are considered as one state
Source: RBI; Census India; CRISIL Research

The number of branches and ATM facilities in the eastern regions, where credit penetration and deposit-base are low is also below those of the southern and western regions, which CRISIL Research believes is largely due to lower focus from the bigger banks.

Region-wise presence of bank ATM and branches (as of March 31, 2022)



*Note: *Population is as per the census data of 2011, Source: RBI; Census India; CRISIL Research*

Large variation in credit availability across states and districts

There is a wide variation across states and within various districts in the same state as well in terms of credit, which indicates latent opportunity for providing banking services to unserved or underserved customers. Uttar Pradesh and Bihar are the most populous states in India, accounting for 17% and 9% respectively of overall population in India, as compared to other states like Assam, Jharkhand and Odisha with share of ~3% each. Based on bank credit accounts in rural areas, Himachal Pradesh, Odisha, Jharkhand and Bihar have more than 45% of the credit accounts in rural areas compared to Maharashtra, Delhi, Kerala where the share of accounts in rural areas is below 10%. In value terms, bigger states like Maharashtra, Delhi, Gujarat and Kerala have less than 10% of credit outstanding in rural areas compared to Meghalaya, Himachal Pradesh and Jammu & Kashmir with more than 30% of rural credit outstanding.

Maharashtra and Delhi, among the states with high share in overall credit, have more than 70% of total credit outstanding concentrated in the top five districts as of FY22.

State-wise rural credit accounts in banks and top five districts concentration (FY22)

State	No. of districts	% Share in overall population in India	Share in overall credit	Credit to Deposit ratio	Concentration of credit in top 5 districts	% of credit in rural areas	Concentration of credit accounts in top 5 districts*	% Credit accounts in rural areas
Maharashtra	36	9%	27%	92%	90%	2%	77%	7%
NCT of Delhi	11	1%	12%	93%	100%	0%	100%	0%
Tamil Nadu	38	6%	9%	99%	62%	11%	44%	27%
Karnataka	31	5%	7%	58%	75%	8%	50%	28%
Gujarat	33	5%	5%	69%	72%	6%	49%	18%
Telangana	33	3%	5%	92%	79%	6%	48%	22%
Uttar Pradesh	75	17%	5%	40%	38%	17%	23%	37%

Andhra Pradesh	26	4%	4%	128%	64%	15%	49%	29%
West Bengal	23	8%	4%	45%	73%	14%	47%	45%
Kerala	14	3%	3%	59%	66%	2%	52%	4%
Rajasthan	33	6%	3%	73%	53%	14%	40%	30%
Madhya Pradesh	52	6%	3%	65%	54%	12%	33%	25%
Haryana	22	2%	3%	53%	62%	8%	44%	19%
Punjab	23	2%	2%	52%	61%	19%	46%	28%
Bihar	38	9%	1%	38%	46%	22%	36%	48%
Odisha	30	3%	1%	39%	61%	19%	47%	51%
Chhattisgarh	28	2%	1%	64%	73%	8%	52%	22%
Assam	34	3%	1%	46%	50%	23%	37%	43%
Jharkhand	24	3%	1%	29%	68%	18%	53%	49%
Chandigarh	1	0%	1%	90%	100%	0%	100%	1%
Jammu & Kashmir	20	1%	1%	49%	60%	35%	50%	50%
Uttarakhand	13	1%	1%	34%	89%	21%	82%	32%
Himachal Pradesh	12	1%	0%	30%	74%	58%	68%	69%
Goa	2	0%	0%	24%	100%	17%	100%	31%
Puducherry	4	0%	0%	60%	100%	10%	100%	15%
Tripura	8	0%	0%	33%	87%	30%	83%	37%
Meghalaya	12	0%	0%	29%	93%	36%	88%	44%
Manipur	16	0%	0%	59%	83%	29%	82%	28%
Nagaland	12	0%	0%	43%	84%	23%	81%	27%
Arunachal Pradesh	25	0%	0%	23%	72%	27%	65%	33%

Note: Arranged in descending order of share in overall credit outstanding of banks, (*) As of FY21
Source: RBI, CRISIL Research

Similarly in terms of bank deposits, Odisha, Jharkhand, Assam, Himachal Pradesh, Sikkim and Meghalaya have more than 50% of the deposit accounts in rural areas compared to Maharashtra, Delhi and Kerala where the share of accounts in rural areas is below 20%. In value terms, Maharashtra, Delhi, Kerala, Karnataka, Tamil Nadu and Haryana have less than 10% of deposits in rural areas compared to Sikkim, Tripura, Meghalaya, Arunachal Pradesh, Himachal Pradesh and Jammu & Kashmir with more than 25% of rural deposits.

Maharashtra and Karnataka, among the bigger states have more than 75% of total deposits concentrated in the top five districts as of FY22.

State-wise rural deposit accounts in banks and top five districts concentration (FY22)

State	No. of districts	% Share in overall population	% Share in overall deposits	Concentration of deposits in top 5 districts	% Of deposits in rural areas	Concentration of deposit accounts in top 5 districts	% Deposit accounts in rural areas
Maharashtra	36	9%	21%	85%	3%	52%	18%
NCT of Delhi	1	1%	9%	100%	1%	61%	2%
Uttar Pradesh	75	17%	8%	41%	19%	16%	46%

Karnataka	31	5%	8%	80%	7%	46%	29%
Tamil Nadu	38	6%	7%	63%	8%	33%	24%
West Bengal	24	8%	6%	70%	17%	43%	48%
Gujarat	33	5%	5%	62%	11%	43%	26%
Kerala	14	3%	4%	63%	3%	53%	4%
Telangana	35	NA	4%	84%	6%	49%	25%
Haryana	22	2%	4%	68%	9%	41%	25%
Rajasthan	33	6%	3%	55%	15%	34%	37%
Madhya Pradesh	52	6%	3%	53%	11%	24%	32%
Punjab	23	2%	3%	57%	21%	47%	32%
Bihar	38	9%	3%	49%	22%	30%	50%
Odisha	30	3%	2%	59%	23%	36%	57%
Andhra Pradesh	20	7%	2%	63%	16%	50%	28%
Jharkhand	24	3%	2%	69%	18%	42%	52%
Chhattisgarh	28	2%	1%	65%	17%	38%	44%
Assam	33	3%	1%	60%	21%	32%	54%
Uttarakhand	13	1%	1%	85%	23%	75%	44%
Jammu & Kashmir	22	1%	1%	69%	28%	50%	51%
Himachal Pradesh	12	1%	1%	74%	59%	67%	75%
Goa	2	0%	1%	100%	24%	100%	34%
Chandigarh	1	0%	1%	100%	1%	100%	3%
Tripura	8	0%	0%	91%	28%	81%	48%
Meghalaya	12	0%	0%	92%	25%	82%	56%
Puducherry	4	0%	0%	100%	6%	100%	17%
Arunachal Pradesh	18	0%	0%	75%	27%	62%	44%
Nagaland	9	0%	0%	95%	11%	87%	26%
Manipur	15	0%	0%	89%	25%	74%	40%
Dadra & Nagar Haveli & Daman & Diu	3	0%	0%	100%	5%	100%	15%
Mizoram	11	0%	0%	89%	12%	79%	34%
Sikkim	4	0%	0%	100%	30%	100%	52%
Ladakh	2	NA	0%	100%	23%	100%	34%
Andaman & Nicobar Islands	3	0%	0%	100%	24%	100%	37%
Lakshadweep	1	0%	0%	100%	29%	100%	41%

Note: Population as of FY21 according to CRISIL estimates, States are arranged in descending order of share in overall deposits of banks

Source: RBI, CRISIL Research

Maharashtra and Tamil Nadu have registered highest credit account penetration in FY22

States like Andhra Pradesh, Karnataka and Uttar Pradesh have huge headroom for growth given the credit penetration and economic growth. Similarly, In the West, states like Maharashtra and Gujarat have showcased good growth in terms of GDP and Gujarat has a relatively lower credit penetration, which provides a huge potential to be addressed.

State-wise GDP and GDP growth (FY 2022)

States	GSDP - Constant Prices FY22 In Rs. Billion	Y-o-Y growth	CAGR (FY22-FY17)	Credit Account Penetration as on FY22	Deposit Account Penetration as on FY22	Branch Penetration as on FY22	ATM Penetration as on FY22	CRISIL Inclusix Score (FY2016)
Tamil Nadu	13,984	7.85%	6.17%	14%	184%	144	337	77.2
Karnataka	12,522	9.47%	5.86%	10%	183%	151	259	82.1
Uttar Pradesh	11,687	7.26%	2.93%	2%	127%	77	100	44.1
Andhra Pradesh	7,469	11.43%	6.69%	6%	156%	122	191	78.4
Rajasthan	7,330	11.04%	4.20%	4%	135%	103	140	50.9
Telangana	6,856	11.22%	6.18%	15%	203%	158	318	72.8
Madhya Pradesh	6,217	10.12%	5.72%	4%	142%	90	132	48.7
Haryana	5,888	9.80%	5.21%	11%	202%	177	235	67.7
Kerala	5,509	7.10%	2.57%	10%	211%	175	278	90.9
Odisha	4,276	10.11%	4.86%	4%	149%	112	163	63
Punjab	4,162	5.12%	3.36%	10%	215%	212	239	70.9
Assam	2,738	9.13%	6.27%	4%	141%	84	120	47.9
Himachal Pradesh	1,244	8.35%	3.84%	5%	189%	213	268	72.3
Jammu & Kashmir	1,239	6.16%	NA	8%	157%	126	182	47.8
Tripura	469	12.16%	8.95%	43%	141%	140	129	66.2
Meghalaya	254	8.89%	3.14%	9%	96%	111	129	34.6

Note:

1. Credit account penetration is calculated as total number of retail bank credit accounts/population of the state
2. Deposit account penetration is calculated as total number of bank deposit accounts/ population of the state
3. Branch penetration is calculated as Number of bank branches per million people
4. ATM penetration is calculated as Number of ATMs per million people
5. For Credit and Deposit account penetration, this does not represent unique borrowers or depositors, total number of accounts have been considered
6. CRISIL Inclusix, India's first financial inclusion index, was launched in 2013 with the objective of creating a dependable yardstick that would become a policy input to further the cause of inclusion. CRISIL Inclusix weighs three service providers (banks, insurers and microfinance institutions) on four dimensions (branch, credit, deposit and insurance).
Source: RBI, MOSPI, CRISIL Research

State-wise GDP and GDP growth (FY 2021)

States	GSDP - Constant Prices FY21 In Rs. Billion	Y-o-Y growth	CAGR (FY21-FY16)	Credit Account Penetration as on FY22	Deposit Account Penetration as on FY22	Branch Penetration as on FY22	ATM Penetration as on FY22	CRISIL Inclusix Score (FY2016)
Maharashtra	18,893	-7.57%	2.69%	43%	176%	106	213	62.7
Gujarat	12,443	-1.95%	6.82%	9%	157%	128	186	62.4
West Bengal	7,927	1.06%	5.40%	4%	160%	91	123	53.7
Delhi	5,647	-3.86%	3.49%	26%	292%	192	400	86.1
Bihar	4,199	2.50%	7.21%	1%	123%	62	73	38.5
Chhattisgarh	2,455	-1.77%	5.19%	4%	145%	98	134	45.7
Jharkhand	2,271	-4.75%	5.36%	3%	145%	90	106	48.2
Uttarakhand	1,759	-6.55%	2.87%	9%	284%	289	378	69.0

Note:

1. Credit account penetration is calculated as total number of retail bank credit accounts/population of the state
2. Deposit account penetration is calculated as total number of bank deposit accounts/ population of the state
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Source: RBI, MOSPI, CRISIL Research

Key steps taken by the government to boost financial inclusion

To improve financial inclusion, especially in rural areas, the Government is focusing on improving the overall and rural infrastructure for penetration of financial services as well as empowering the development of parallel supporting institutions. This has provided an opportunity for payment banks and other financial institutions to cater to the unserved population or act as a channel between the larger financial institutions and other service providers to better serve the underserved customers.

Considerable progress has been made over the past 5-7 years to bring unbanked individuals into the formal banking system. The RBI and the Government have taken several measures, such as:

Pradhan Mantri Jan Dhan Yojana

Pradhan Mantri Jan Dhan Yojana (PMJDY), launched in August 2014, is aimed at ensuring affordable access to financial services – banking/savings and deposit accounts, remittances, credit, insurance, and pension.

PMJDY focuses on household coverage as compared with the earlier schemes that focused on coverage of villages. It aims to extend banking facilities to all within a reasonable distance in each sub-service area (consisting of 1,000-1,500 households) across India.

As on March 31, 2022, 464 million PMJDY accounts had been opened, of which, 67% were in rural and semi-urban areas, with total deposits of Rs.1725 billion.

Although the opening of Jan Dhan accounts has increased financial inclusion, the high proportion of zero-balance or dormant accounts is a concern. However, the number of inoperative accounts under PMJDY is declining, as per the official website of the Government of India. The data shows that the percentage of inoperative accounts (of total Jan Dhan accounts) declined from 76.8% in September 2014 to less than 14% in August 2020.

While the Government's move to route subsidies through this channel is a major reason for decreasing zero-balance accounts, the increased availability of low-cost financial instruments is popularising formal financial institutions amongst the unbanked population. In fact, since the launch of the insurance and pension Jan Suraksha schemes in August 2015, the proportion of dormant accounts has fallen. (*Source: Global Findex Database, 2017*)

With various other schemes, such as Pradhan Mantri Social Security Schemes including Pradhan Mantri Jeevan Jyoti Bima Yojana, Atal Pension Yojana and Pradhan Mantri Suraksha Bima Yojana being run under PMJDY, people have ample reason to enrol for the PMJDY.

Pradhan Mantri Suraksha Bima Yojana: PMSBY was launched on May 9, 2015. It offers a renewable one-year accidental death cum disability cover of Rs 200,000 to all subscribing bank account holders in the age group of 18 to 70 years for a premium of Rs.12 per annum per subscriber. As of 27 April, 2022, 284 million people were enrolled under the scheme and amount of Rs. 19.3 billion has been paid for 97,227 claims.

Pradhan Mantri Jeevan Jyoti Bima Yojana: PMJJBY was launched on May 9, 2015. It offers a renewable one year term life cover of Rs.200,000 to all subscribing bank account holders in the age group of 18 to 50 years, covering death due' to any reason, for a premium of Rs.330/- per annum per subscriber. The scheme is offered / administered through Life Insurance Company (LIC) and other life insurance providers willing to offer the product on similar terms. As on 27 April, 2022, 127 million people have been enrolled under this scheme and amount of Rs. 11,522 crore has been paid for 576,121 claims.

Atal Pension Yojana: The Atal Pension Yojana (APY) was launched on May 9, 2015 to create a universal social security system for all Indians, especially the poor, the under-privileged and the workers in the unorganised sector. APY is administered by Pension Fund Regulatory and Development Authority (PFRDA). APY is open to all bank account holders in the age group of 18 to 40 years and the contributions differ, based on pension amount chosen. Subscribers would receive the guaranteed minimum monthly pension of Rs. 1,000 or Rs. 2,000 or Rs. 3,000 or Rs. 4,000 or Rs. 5,000 at the age of 60 years. As of April 27, 2022, there were more than 40 million subscribers for this scheme.

Pradhan Mantri Mudra Yojana ("PMMY"): PMMY is a scheme launched by the Hon'ble Prime Minister on April 8, 2015 for providing loans up to Rs 1 million to the non-corporate, non-farm small/micro enterprises. These loans are classified as Micro Units Development and Refinance Agency (MUDRA) loans under PMMY. These loans are given by Commercial Banks, Regional Rural Banks (RRBs), Small Finance Banks, MFIs and NBFCs. As of fiscal 2022, Rs. 9.98 lakh crore has been sanctioned to 16.67 crore loan accounts under Pradhan Mantri Mudra Yojana in 3 years. According to a survey conducted by Ministry of Labour and Employment, PMMY helped in generation of Rs. 1.12 crore net additional employment during a period of three years (2015-2018).

Standup India Scheme: The scheme was launched by the Hon'ble Prime Minister on April 5, 2016. The objective of the scheme is to facilitate bank loans between Rs.1 million and Rs. 10 million to at least one Scheduled Caste (SC) or Scheduled Tribe (ST) borrower and at least one woman borrower per bank branch for setting up a Greenfield enterprise. This enterprise may be in manufacturing, services, agri-allied activities or the trading sector. In case of non-individual enterprises at least 51% of the shareholding and controlling stake should be held by either an SC/ST or woman entrepreneur. As of March 31, 2022, 168,012 applications amounting to more than Rs.334 billion have been sanctioned under the scheme.

Payment banks

Another step taken towards financial inclusion was the RBI granting in-principle approval on August 19, 2015 to 11 players to launch payment banks. The decision came after the recommendations from Nachiket Mor Committee to set up a specialized bank ("Payments Bank") to cater to the low income groups. After the licences were granted to 11 players, three players withdrew their application. Of the remaining eight, seven institutions – India Post Payments Bank Ltd, Airtel Payments Bank Ltd, PayTM Payments Bank Ltd, Fino Payments Bank, Aditya Birla Idea Payments Bank Ltd and Jio Payments Bank and NSDL Payments Bank had commenced operations. In 2019, Aditya Birla Payments Bank Ltd shut down its operations due to mounting losses.

The objective of a payments bank is to widen the spread of payment services and deposit products to small businesses, low-income households, migrant labour workers and other unorganized entities by enabling high volume low value transactions in deposits and payments/remittance services in a secured technology-driven environment.

Payment banks can accept deposits, subject to a cap of Rs. 200,000 per customer, and provide payment and remittance services through channels, such as the internet, branches, business correspondents (BCs) and mobile banking. (The deposit limit was enhanced to Rs.200, 000 from the earlier limit of Rs. 100,000 in April 2021.) However, these banks cannot offer credit facilities directly, but can choose to act as a BC of another bank for credit and other services.

Along with maintaining a cash reserve ratio (CRR) with the RBI, payment banks are required to invest a minimum of 75% of their demand deposit balance in Government securities eligible under the statutory liquidity ratio (SLR), with maturity of up to one year, and hold a maximum 25% in current and fixed deposits with Scheduled Commercial Banks (SCBs). As of March 31, 2021, the total deposits with payment banks stood at Rs 25 billion.

Small Finance Banks (SFBs)

As of July 2021, the RBI had awarded SFB licenses to 12 institutions, which aim to service the underserved customers through savings instruments, and supplying credit to small business units, small and marginal farmers, micro and small industries, and other unorganised sector/lending through informal channels. SFBs are also required to dedicate 75% of their Adjusted Net Bank Credit (ANBC) towards priority sector. For the SFBs, nearly 19% of their deposits arise from the rural and semi-urban areas, whereas the credit view shows that 39% of their advances are extended in rural and semi-urban areas as of March 31, 2022. This has led to increasing credit penetration in rural areas, thereby ensuring financial inclusion.

Microfinance Institutions

MFIs have significant role to play in furthering financial inclusion, by providing small ticket loans to customers, usually for productive purposes. As of March 31, 2022, Microfinance segment has a total loan amount outstanding of Rs. 2,854 billion of which 40% was financed by Banks and 35% by NBFC-MFIs.

Business Correspondents (BCs)

In one of its foremost measures, the RBI introduced the BC model of banking outreach in January 2006, aimed at leveraging information and communication technology to widen access to the banking system. BCs are retail agents engaged by banks to offer banking services at locations other than a bank branch/ATM. They are authorised to perform a variety of activities including collection of small-value deposits, disbursal of small-value credit, recovery of principal, collection of interest, sale of micro insurance, mutual fund products, pension products, other third-party products, and receipt and delivery of small value remittances/other payment instruments. In July 2014, the RBI allowed NBFC-MFIs to work with banks as BCs. As of December 2020, 360 million basic savings bank deposit accounts (BSBDA) were opened through BCs (*Source: RBI*)

Aadhaar

Adoption of Aadhaar and Aadhaar authentication in the Indian financial system is expected to transform the financial landscape. To increase financial inclusion, the Unique Identification Authority of India partnered with the RBI, National Payments Corporation of India (NPCI), Indian Banks Association (IBA) and banks to develop:

- Aadhaar Payments Bridge (APB) – The system was launched in 2011 to enable a smooth transfer of all government welfare scheme payments to a beneficiary's Aadhaar Enabled Bank Account (AEBA)

- Aadhaar enabled payment system (AEPS) – A system that leverages Aadhaar online authentication and enables AEBAs to be operated in anytime-anywhere banking mode by the marginalised and financially excluded via micro ATMs

According to the Ministry of Electronics and IT, Aadhaar-generated unique identity covered over 99% of total estimated adult population of India, as of December 2020. An Aadhaar number will be used to verify the identity of a person receiving a subsidy or a service. Disbursements will take place through a centralised electronic benefit transfer system using the unique Aadhaar beneficiary numbers.

The Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Bill, 2016, came into effect on March 25, 2016, to strengthen the role of the Aadhaar card. The Bill aims at providing targeted delivery of subsidies and services to individuals residing in India by assigning them a unique Aadhaar numbers. To reduce the cost of consumer on-boarding and transactions, the government launched IndiaStack. IndiaStack is a set of APIs that allows government businesses, start-ups and developers to utilise a unique digital infrastructure to solve problems, such as presence less, paperless and cashless services delivery.

Also, Aadhaar-enabled micropayments have many features, including elimination of the need for individual KYC requirements by banks for no-frills or basic accounts, and reductions in the direct and indirect KYC cost of financial institutions on account of the UIDAI's 'know your residence' standards being sufficient for authentication.

Aadhaar-enabled payments with clear authentication and verification process allow financial institutions to network with village-based BCs. Thus, customers will be able to withdraw money and make deposits at the local BC. UIDAI's authentication will help banks verify residents both in person and remotely. The electronic transfer, backed by UIDAI's authentication, will help residents transact electronically, reducing the cost of transactions. Also, it has helped reduce the KYC approval turnaround time from the previous 10-15 days, when the customer had to submit various documents for identity and address proof, to almost-instant KYC approval.

As per the Supreme Court's Judgment of September 2018, the Aadhaar Act was held constitutional, however, it was also held that Aadhaar cannot be made mandatory for availing banking services and body corporates/persons were restrained from using Aadhaar details pursuant to a contract only. It further held that the use of the Aadhaar must be backed by a legislation. Accordingly, the amendment in the legislation was brought about in February 2019, whereby banks were allowed to use Aadhaar for KYC but with customer consent. This enabled banks to open instant bank accounts using eKYC based on Aadhaar authentication through the OTP mode. The change in the RBI's KYC guidelines is in line with the changes made by the government to the Prevention of Money-laundering Rules (PMLA) in February 2019 and the Aadhaar and Other Laws (Amendment) Ordinance, 2019 (passed in Lok Sabha in July 2019). The Department of Revenue, vide its circular issued in May 2019, had also notified that all regulated entities may approach their respective regulators to seek Aadhaar authentication facilities. However, fintech companies are still not allowed to use biometrics or OTP-based eKYC and are only permitted to use offline Aadhaar verification. Furthermore, maximum lending through OTP-based e-KYC is Rs 60,000.

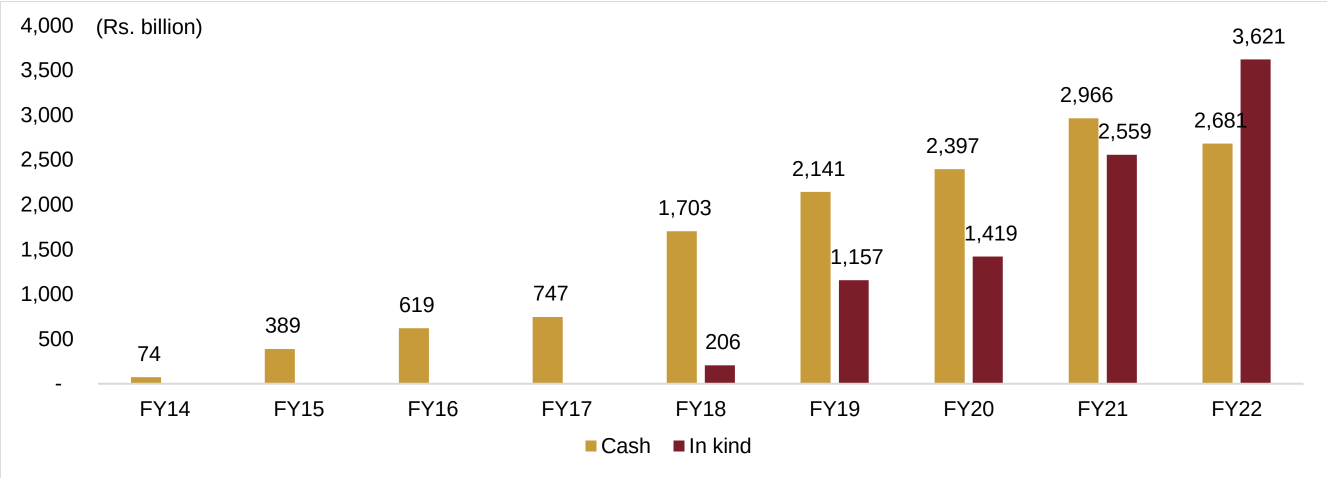
Digital India

An umbrella programme to transform India into a knowledge economy has supported the financial inclusion initiative. Some of the initiatives under this programme include development of digital infrastructure, delivery of government services digitally and improvement in digital literacy, especially in rural India.

Some of the initiatives include:

- **Direct-benefit transfer:** As of end of fiscal 2014, only 28 schemes were covered under the direct-benefit transfer (DBT), where the payment is directly done into the bank account of the beneficiary. This has grown to 318 schemes as of the end of fiscal 2022. Benefit transfer in form of cash through the DBT mechanism has increased from approximately Rs. 2,141 billion in fiscal 2019 to Rs. 2,397 billion in fiscal 2020 to Rs 2,966 billion in fiscal 2021 to Rs. 2,681 billion in fiscal 2022. This has resulted in fewer slippages, and faster and easier remittance to the intended. This, in turn, is expected to give rise to the usability of agent network for other related transactions, when the money is already in the bank accounts of customers. CRISIL Research expects the availability of funds in the bank accounts of the beneficiaries will support growth in digital transactions.

Amount transferred to beneficiaries through DBT



Note: DBT also includes in-kind transfers which includes transfer of goods and services at very low price or for free to the beneficiaries of various such Government schemes, Source: DBT website; CRISIL Research

- **Common service centres 2.0:** This is a service delivery-oriented entrepreneurship model, with a large variety of services made available for citizens. Under Digital India, at least one common service centre (CSC) was envisaged for each of the 250,000 gram panchayats, including the 100,000 operational CSCs launched in the initial version of the programme. The objectives of the programme include:

– Non-discriminatory access to e-services for rural citizens

– Expanding the self-sustaining CSC network to the gram panchayat level

– Empowering District e-Governance Societies (DeGSs) under the district administration for implementation

– Creating and strengthening the institutional framework for rollout and project management, thereby supporting the state and district administrative machinery

– Enabling and consolidating online services under a single technology platform

– Providing a centralised technological platform for delivery of services, transparently to citizens

– Increasing the sustainability of village-level entrepreneurs (VLEs) by sharing maximum commission earned through delivery of e-services and encouraging women to join as VLEs

The services to be provided at the CSCs include agriculture services, education and training services, rural banking and insurance services, entertainment services, utility services, healthcare services, and other commercial services.

- **BharatNet:** This project aims to provide 100 Mbps broadband connectivity to almost all the 0.25 million gram panchayats in the country. Under the first phase of the project, 100,000 gram panchayats were to be connected by laying underground optical fibre cable (OFC). Under Phase-II, targeted to be completed by March 2019, connectivity will be provided to the remaining 0.15 million gram panchayats, using an optimal mix of underground fibre, fibre over power lines, radio and satellite media. As per Bharat Broadband Network Limited (BBNL), ~0.14 million gram panchayats have been linked with this.

Moreover, under the 'Digital India program', the government also proposed to provide free-high speed Wi-Fi in 2,500 cities and towns, at an estimated investment of Rs 70 billion. Under the plan, the government aims to set up 50,000-60,000 Wi-Fi hotspots across the country.

CRISIL Research expects, on completion, these projects will help catalyse the growth of digital services to the rural masses, and especially to the lower category of the population. This strengthening of digital infrastructure will help various sectors including healthcare, education, skills training, etc. It would provide the private enterprises with an opportunity to expand their services in these remote underserved areas.

Priority sector lending aimed at facilitating financial inclusion

The definition of 'priority sector' was formalised in 1972, based on a report submitted by the Informal Study Group on Statistics, relating to advances to priority sectors, constituted by the RBI in May 1971. The requirement for PSL as a proportion of Adjusted NBC was set at 33.3% for SCBs in 1979, and raised to the current 40% in 1985. Currently, all banks including foreign banks need to comply with this 40% requirement.

Targets and sub-targets for banks were further classified under the priority sector and revised at intervals. As per the latest regulations, unveiled in 2015, medium enterprises, social infrastructure and renewable energy are part of the priority sector, in addition to the existing categories. Also, non-achievement of priority sector targets has been assessed on a quarterly average basis at the end of the respective year, from fiscal 2017 onwards, instead of annually.

As per the RBI, these sub-divisions include:

- **Agriculture:** For all SCBs, 18% of the ANBC or the credit equivalent amount of off-balance sheet exposure (CEOBE), whichever is higher, is to be extended for agriculture. Within the 18% target for agriculture, a target of 10% of ANBC or CEOBE, whichever is higher, has been prescribed for small and marginal farmers. Also, the sub-target of 10% of ANBC or the CEOBE, whichever is higher, is applicable for foreign banks with 20 branches or more, for lending to small and marginal farmers.

- **Social infrastructure:** A maximum bank loan of Rs 50 million will be extended per borrower to build social infrastructure, including schools, healthcare, drinking water, and sanitation facilities, as well as construction/ refurbishment of household toilets and household-level water improvements in tier II to VI centres. Bank credit to MFIs, extended for on-lending to individuals and to members of self-help groups (SHGs)/ joint lending groups for water and sanitation facilities, will be eligible for categorisation as the priority sector under 'social infrastructure'.

- **Renewable energy**: Bank loans up to Rs 150 million will be given to borrowers for solar-based power generators, biomass-based power generators, wind mills, micro-hydel plants, and for non-conventional energy-based public utilities (street lighting systems), and remote village electrification. For individual households, the loan limit is Rs 1 million per borrower.

- **Microcredit:** As much as 7.5% of ANBC or the CEOBE for all SCBs should be given in the form of microcredit. Further, the sub-target of 7.5% of ANBC or CEOBE, whichever is higher, for banks' lending to microenterprises will also be applicable to foreign banks with 20 branches and above from fiscal 2019.

- The RBI has also removed the currently applicable loan limits of Rs 50 million and Rs 100 million per borrower to micro/small and medium enterprises (services), respectively, for classification under the priority sector. Accordingly, all bank loans to MSMEs, engaged in the provision or rendering of services as defined in terms of investment in equipment under the MSMED Act, 2006, will qualify under the priority sector without any credit cap.

- **Advances to weaker sections:** 12% of ANBC or the CEOBE, whichever is higher, must to be extended to weaker sections. Foreign banks with 20 branches or more had to achieve the weaker sections target within five years, between April 1, 2013 and March 31, 2018, as per the action plan submitted by them and approved by the RBI.

- **Education loans:** These include loans and advances granted to individuals only for educational purposes, including vocational courses, of up to Rs 1 million. These loans and advances will be considered eligible for the priority sector.

- **Housing:** The government has tried to bring greater convergence of PSL guidelines for housing loans with the Affordable Housing Scheme and boost low-cost housing for economically weaker sections and lower income groups. Thus, it decided to revise the housing loan limits for PSL eligibility from the existing Rs 2.8 million to Rs 3.5 million in metropolitan centres (with a population of 1 million and above), and from the existing Rs 2 million to Rs 2.5 million in other centres, provided the overall cost of the dwelling unit in the metropolitan centre and at other centres does not exceed Rs 4.5 million and Rs 3 million, respectively.

For foreign banks with less than 20 branches, no specific sub-targets for sectors are laid out. For these banks, up to 32% can be in the form of lending to exports and not less than 8% can be to any other priority sector.

In September 2020, RBI new guidelines for PSL, wherein higher weights would be assigned to districts having a relatively lower credit penetration. From FY22, a weight of 125% would be assigned to incremental priority sector credit in identified districts where credit flow is lower and per capita PSL is lower than Rs 6,000. A lower weight of 90% will be assigned to incremental PSL in identified districts where credit flow is relatively higher and per capita PSL is more than Rs 25,000. Other districts will continue to have the existing weightage of 100%. This will incentivise credit flow to credit deficient geographies.

Business opportunities available owing to financial inclusion on the asset and liability side

Factors such as lack of documents, migration of individuals for work or other purposes, lack of transaction history with financial institutions, etc., have led to low inclusion of households in the financial system. Also, the costs involved in setting up a network to serve the traditionally ignored categories, such as migrants, rural population, retailers, shop owners, and MSMEs, is high.

In addition, the gap between various regions of the country, as highlighted above, is very wide. However, owing to the Government's emphasis and growth of the banking facility in these regions, the gap is slowly getting plugged. This gives financial institutions an opportunity to expand their services in underserved regions.

Key business opportunities among various population categories - assets and liabilites

Migrants - ~100 million migrant workforce

- Remittance services
- Account services
- Deposit services

Retailers - ~24-25 million retail outlets

- Payments
- Loans
- Digitalisation of business functions

MSME - ~70 million businesses

- MSME loans
- Working capital finance
- Fee-based services

Rural population - ~ 66% of India's population

- Basic banking services
- Personal loans
- Bill payments and bookings
- Investment in mutual funds and insurance products
- Education loans
- Gold loans

Source: CRISIL Research

MSME sector in India

Brief overview of MSMEs in India

The National Sample Survey (NSS) 73rd round dated June 2016 estimated that there are around 63.5 million MSMEs in India. Since then, the number of MSMEs is estimated to have increased further to around 70 million as of fiscal 2022. MSMEs complement large corporates as suppliers or directly cater to end users. The MSME sector contributes to India's socio-economic development by providing huge employment opportunities in rural and backward areas, reducing regional imbalances, and assuring equitable distribution of national wealth and income. The segment currently contributes to 30% of the GDP, over 40% of exports and creates employment for about 110 million people in the country, thus supporting economic development and growth.

MSME segment account for 30% of India's GDP

Rs trillion	Total MSME GVA	Growth (%)	Total GVA	Share of MSME in GVA (%)	All India GDP	Share of MSME in All India GDP (in %)	Number of MSMEs (in millions) *
FY16	41	11.0%	126	32.3%	138	29.5%	63.5
FY17	45	10.9%	140	32.2%	154	29.3%	65.5
FY18	51	13.0%	155	32.8%	171	29.7%	66.5
FY19	57	12.9%	171	33.5%	190	30.3%	68.5

Note: (*) - Estimated
Source: MSME Ministry Annual report for FY21[6], CRISIL Research

Snapshot of MSMEs in India

*Note: *Data as of FY19, ** Data as of FY22, ^The numbers are estimated*
Source: MSME Ministry Annual report for FY21, CRISIL Research

[6] *https://msme.gov.in/sites/default/files/MSME-ANNUAL-REPORT-ENGLISH%202020-21.pdf*

The RBI has adopted the definition of MSMEs in line with the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006. This definition is based on investments in plant and machinery in the manufacturing and services sectors.

To bring in more enterprises under the ambit of MSMEs and widen the definition of MSMEs taking into account inflation over the past few years, in June 2020, the Government revised the MSME investment limit across each category and introduced an alternate and additional criterion of turnover buckets to the definition. It further removed the difference between the definition of manufacturing based and services based MSMEs.

In June 2021, the Indian government has included retailers and wholesalers under the MSMEs definition to extend the benefits of priority sector lending to traders as well. The move is structurally positive from long-term perspective, as it will enable entities operating in the segment to register on Government's Udyam portal, participate in government tenders and also avail financing options/benefits available to the category.

Given below is the composite new, revised definition of MSMEs in comparison to the old existing one:

New MSME definition removed distinction between manufacturing and services

Old MSME classification			
Criteria: Investment in plant and machinery or equipment			
Classification	**Micro**	**Small**	**Medium**
Manufacturing enterprises	Investment < Rs. 2.5 million	Investment < Rs. 50 million	Investment < Rs. 100 million
Services enterprises	Investment < Rs. 1 million	Investment < Rs. 20 million	Investment < Rs. 50 million
Revised MSME classification			
Composite Criteria: Investment and annual turnover			
Classification	**Micro**	**Small**	**Medium**
Manufacturing and Services enterprises	Investment < Rs. 10 million and Turnover < Rs. 50 million	Investment < Rs. 100 million and Turnover < Rs. 500 million	Investment < Rs. 500 million and Turnover < Rs. 2.5 billion

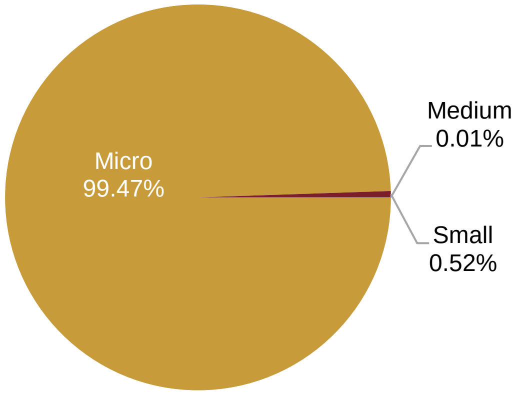
Source: MSME Ministry, CRISIL Research

Financial institutions also use internal business classifications to define MSMEs, based on their turnover. Most banks and non-banks follow this practice.

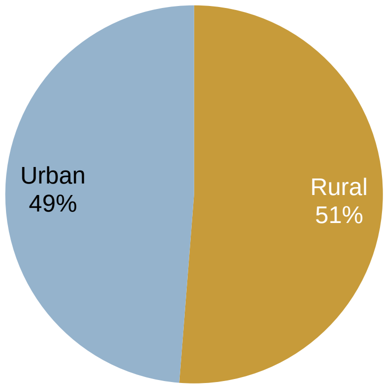
According to the National Sample Survey (NSS) 73rd round dated June 2016, micro segment accounted for as much as ~ 99.47% of total estimated number of MSMEs in India. Small and medium sector accounted for 0.52% and 0.01%, respectively of the total estimated MSMEs. At a region level, rural regions accounted for marginally higher share of 51% as compared to urban region. MSMEs units are largely dominated by bigger states including Uttar Pradesh, West Bengal, Tamil Nadu, Maharashtra and Karnataka. The top 5 states together accounted for ~50% of the total number of MSMES in India. Service sector accounts for dominant 79% share in MSMEs, of which retail forms major share.

In terms of constitution, close to 94% of the entities in the MSME universe in India are estimated to be sole proprietorship firms, wherein a small business undertaking is run and managed by the business owner and the business, and the owner can virtually not be separated.

Micro segment accounts for dominant share



Rural region accounts for marginally higher share



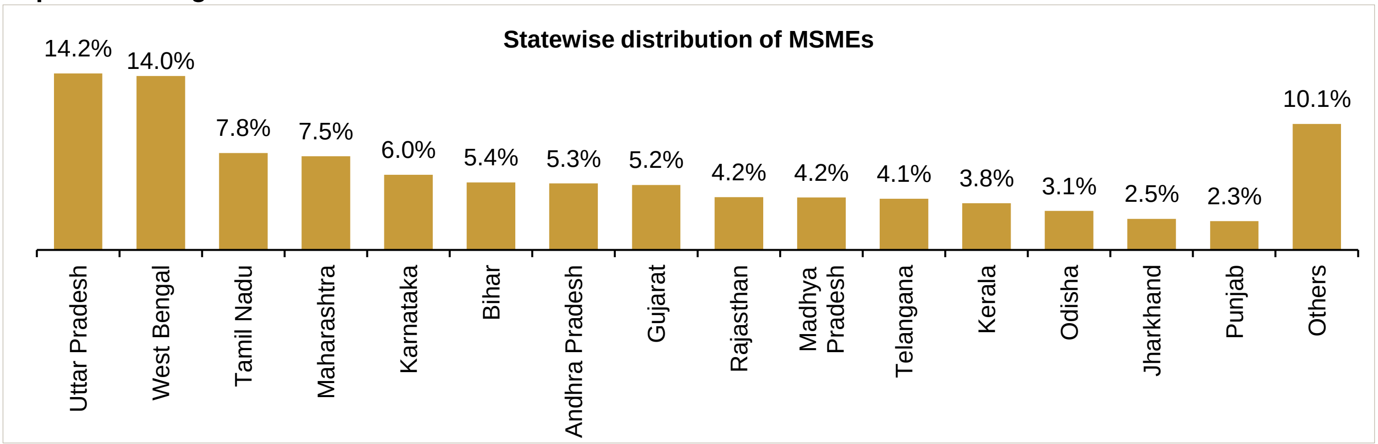
Source: National Sample Survey (NSS) 73rd round dated June 2016, CRISIL Research

MSMEs are largely dominated by individuals

Entities	Share in number of MSMEs
Proprietorship	93.83%
Partnership	1.53%
Private Company	0.23%
Cooperative	0.13%
Public Company	0.04%
Others	4.24%

Source: IFC[7], CRISIL Research

Top 5 states together form ~50% of total MSME units



Source: National Sample Survey (NSS) 73rd round dated June 2016, CRISIL Research

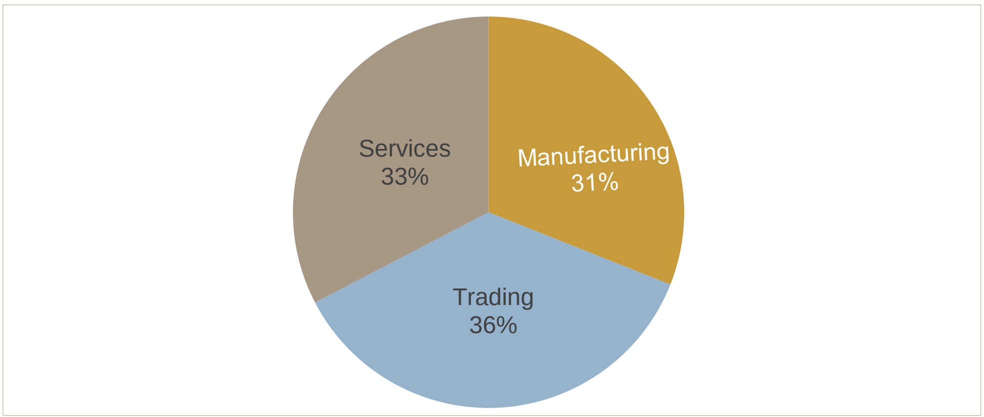
[7] *https://www.ifc.org/wps/wcm/connect/dcf9d09d-68ad-4e54-b9b7-614c143735fb/Financing+India%E2%80%99s+MSMEs+Estimation+of+Debt+Requirement+of+MSMEs+in+India.pdf?MOD=AJPERES&CVID=my3CmzI*

State-wise number of Micro, Small and Medium enterprises in India

States	Micro	Small	Medium	Total MSME
Uttar Pradesh	89,63,623	35,531	332	89,99,487
West Bengal	88,40,924	25,983	528	88,67,435
Tamil Nadu	49,26,652	20,812	157	49,47,621
Maharashtra	47,59,959	17,144	469	47,77,572
Karnataka	38,24,909	9,049	42	38,34,000
Bihar	34,41,300	4,259	2	34,45,561
Andhra Pradesh	33,74,136	12,556	290	33,86,983
Gujarat	32,66,544	49,744	113	33,16,400
Rajasthan	26,65,918	20,169	579	26,86,665
Madhya Pradesh	26,42,023	30,984	925	26,73,932
Telangana	25,93,968	10,048	555	26,04,571
Kerala	23,58,300	20,716	378	23,79,395
Odisha	19,79,769	4,311	348	19,84,428
Jharkhand	15,77,873	9,946	51	15,87,870
Punjab	14,56,274	8,681	58	14,65,012
Others	63,79,356	50,933	453	64,30,740
All India	**6,30,51,524**	**3,30,866**	**5,282**	**6,33,87,673**

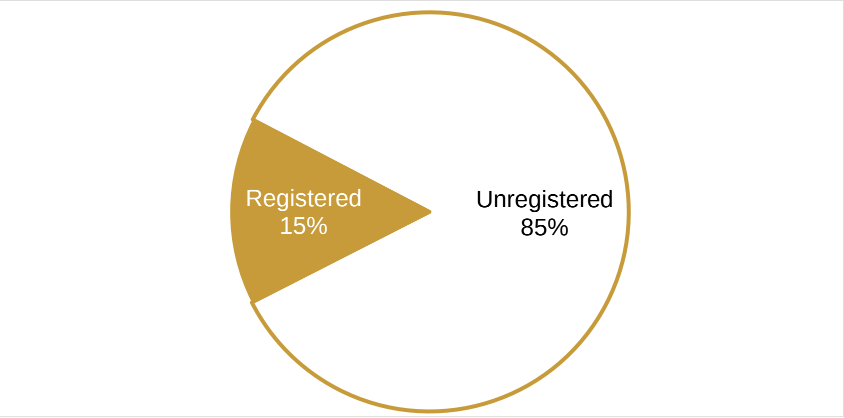
Source: National Sample Survey (NSS) 73rd round dated June 2016, CRISIL Research

Trading sector accounts for higher share in number of MSMEs



Source: MSME Ministry, CRISIL Research

Only 15% of MSMEs are registered (FY17)



Note:Registered MSMEs includes entities that file business information with District Industry Centers (DCs) of the State / Union Territory
Source: IFC, CRISIL Research

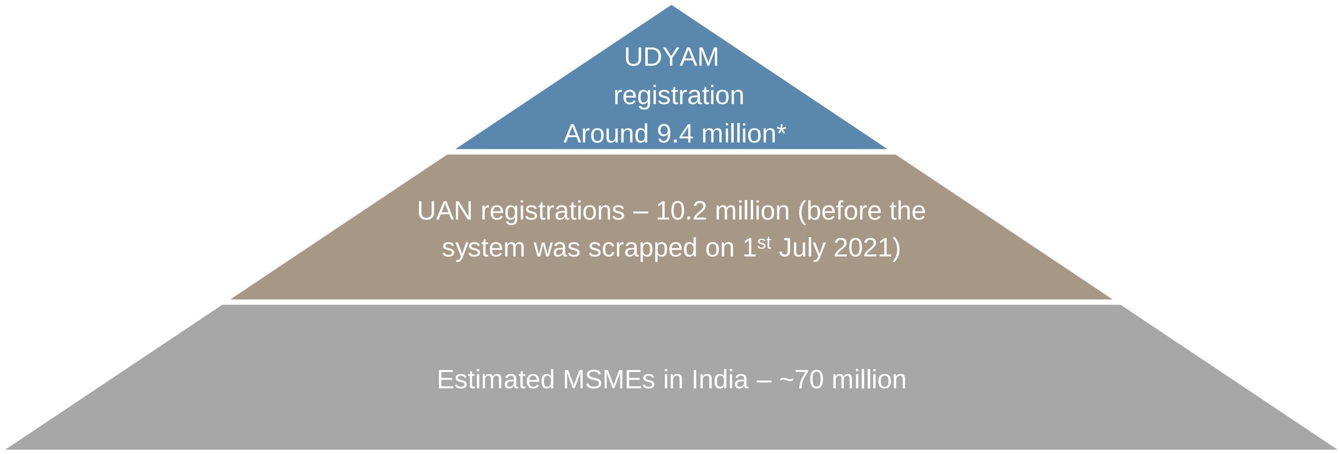
Small fraction of MSMEs in India registered under UDYAM system

After the government revised the definition of MSMEs (in June 2020), MSMEs that had an existing MSME registration (Udyog Aadhaar Number or UAN) or Enterprise Memorandum (EM) were required to re-register themselves under UDYAM. Thereafter, in August 2020, the RBI issued a notification allowing financiers to obtain the UDYAM certificate from entrepreneurs for lending purposes.

As of July 5, 2022, close to 9.4 million MSMEs have registered on UDYAM. Slightly higher number of MSMEs – around 10.2 million – were registered on the erstwhile UAN system. This number pales in comparison to the total number of MSMEs in India, estimated at around 70 million

Like UAN, UDYAM also offers free, paperless online and instant registration through a web portal. Small businesses aren't required to upload any documents or proof except the Aadhaar number for registration. Earlier GST registration was mandatory for UDYAM Registration but from March 2021 onwards, it is exempted for those units who are not eligible for GST registration.

UDYAM certificate will be required by MSMEs for taking benefit of any scheme of the Central government. The UDYAM portal is also integrated with the Government e-Marketplace (GeM) and the Trade Receivables and Discounting System (TReDS) so that enterprises can participate in government procurement and have a mechanism for discounting their bills.



*Note: *As of July 2022, Source: MSME Ministry, CRISIL Research*

Probable reasons for low registration rates

- Earlier, the requirement was that companies that wanted to register under UDYAM had to provide their GSTIN. Since many entities have a turnover of less than Rs 40 lakh and hence do not need to be GST compliant, they were ineligible to register on the UDYAM system. This requirement was removed by the MSME Ministry in early March 2021.
- Low levels of awareness regarding the roll-out of schemes, their eligibility conditions, paperwork requirements and grievance redressal mechanisms could have also impacted the registration of MSMEs. As per the NCAER Business Expectations Survey (BES) in December 2020, 75% of MSMEs were not even aware of Emergency Credit Line Guarantee Scheme (ECLGS) launched by the Government post-COVID.

MSME Credit gap estimated at Rs 85 trillion; COVID-19 has further widened the credit gap

High risk perception and prohibitive cost of delivering services physically have constrained formal lending to MSMEs. The emerging self-employed individual and micros, small and medium enterprise segment is largely unaddressed by lending institutions in India. An IFC report titled Financing India's MSMEs (November 2018) estimated the MSME credit demand at Rs 69.3 trillion in fiscal 2017, of which only ~16% of demand was met through formal financing[8] and consequently, the MSME credit gap *(defined as the gap between the demand for funds amongst MSMEs and the supply from formal financiers)* was estimated at Rs 58.4 trillion. This gap was met through informal sources including moneylenders, chit funds and personal sources from friends and relatives. The interest rate for these sources generally ranges between 30-60% per annum.

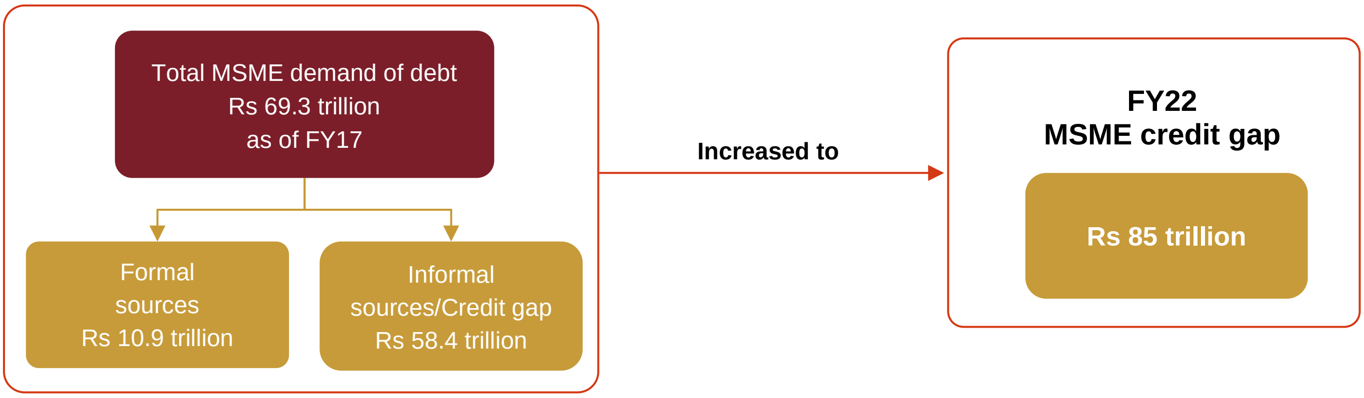
The credit gap is estimated to have further widened over the last 4 years due to slower economic growth in fiscal 2020, followed by the COVID-19 pandemic in fiscal 2021. In fiscal 2021, the nationwide lockdown to contain the spread of the COVID-19 pandemic disrupted economic activity, hurt demand, impacted working capital needs and supply chain along with future investments and expansions. Domestic supplies and supplies from imports also suffered, affecting both, their availability and cost. Contractual and wage labour were also hit due to lower demand and layoffs. MSMEs and businesses in the sectors such as hotels, tourism, logistics, construction, textiles and gems

[8] Formal sources include Public sector banks, Private sector banks, Foreign banks, Regional rural banks (RRBs), Urban Cooperative Banks (UCBs), NBFCs, and government institutions including SIDBI and State Finance Corporations (SFCs).

and jewellery suffered the most during the first half of the fiscal. Businesses in the retail sector, especially those catering to daily usage goods and everyday cash and carry businesses such as grocery shops, fruits and vegetables sellers, etc., however, fared relatively better as their availability close to the residences of customers' increased the demand for their services.

Furthermore, government schemes post the COVID-19 pandemic such as the ECLGS scheme provided relief only to MSME units with existing loans from a formal financial institution. With economic recovery in fiscal 2022, MSME credit growth also recovered. As of fiscal 2022, the MSME credit demand is estimated to be around Rs 106 trillion, of which 20% of demand met through formal financing. Assuming an increase of around 9% annually[9] in the demand for credit and the availability of credit from formal sources, CRISIL Research estimates the credit gap to have increased to Rs 85 trillion as of fiscal 2022.

MSME credit demand largely met by informal sources



Source: IFC report on Financing India's MSMEs dated November 2018[10], CRISIL Research

Even while the credit gap has increased, new MSME units continue to be set up across India. Between fiscals 2016 and 2022, 18.3 million units were set up, according to the Indian government registration data of MSMEs. Thus, though a myriad of small businesses is set up every day in the country, access to credit remains a challenge. However, the industry has witnessed an increase in access to formal credit to MSME, which could be attributed to the increase in the number of registered MSMEs to 61,07,641 in fiscal 2022 from 4,95,013 in fiscal 2016. According to Udhyam Registration Publication, Maharashtra, Tamil Nadu, and Gujarat cumulatively accounts for 39% of overall MSME registration. Further, under the micro category, the maximum number of registrations were from Maharashtra followed by Tamil Nadu, Rajasthan, Uttar Pradesh, and Gujarat. Under small and medium category, maximum registrations were from Maharashtra followed by Gujarat and Tamil Nadu.

Smaller enterprises relatively more starved of credit

While the overall MSME credit gap is estimated at Rs 85 trillion, analysis of both SME gradings assigned by CRISIL between January 2010 to September 2015 and the Fourth Census of the MSME sector (2009) suggests that smaller

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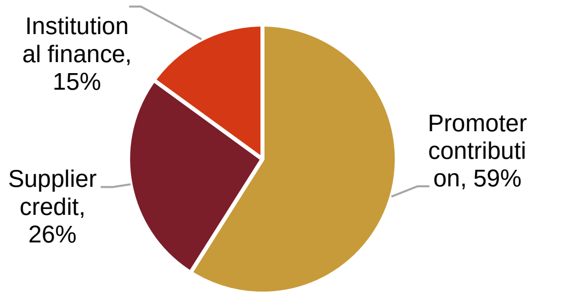
[9] *Based on MSME credit growth over fiscal 2017-22*

[10] *https://www.ifc.org/wps/wcm/connect/dcf9d09d-68ad-4e54-b9b7-614c143735fb/Financing+India%E2%80%99s+MSMEs+Estimation+of+Debt+Requirement+of+MSMEs+in+India.pdf?MOD=AJPERES&CVID=my3CmzI*

enterprises are much more starved of institutional credit, and therefore, they primarily depend on promoter contribution for working capital and fund requirements. While the access to funding has improved in the last few years, credit remains out of bounds for large swathes of the MSME population in India.

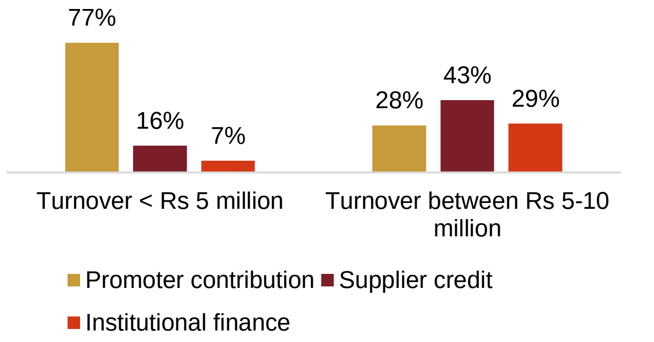
Dependence on various sources of finance for working capital needs for enterprises with turnover below Rs 10 million



Note: Based on an analysis of 12,000 SMEs graded by CRISIL between January 2010 and September 2015

Source: CRISIL Ratings

Smaller enterprises much more starved of access to institutional finance



Note: Based on an analysis of 12,000 SMEs graded by CRISIL between January 2010 and September 2015

Source: CRISIL Ratings

Sources of finance for SMEs with credit requirements of Rs 1 lakh to Rs 25 lakh

Source	Proportion of finance
Finance from institutional sources	5.2%
Finance from non-institutional sources	2.0%
No access to credit or self-financing	92.8%

Source: Fourth Census of the MSME sector (September 2009)

Year-wise and MSME category-wise registration of MSMEs

Year/Category	FY16	FY17	FY18	FY19	FY20	FY21*	FY22^	Cumulative total for last 7 years
Micro	4,21,516	21,47,908	13,44,612	18,70,932	22,48,730	35,95,577	49,75,082	166,04,357
Small	70,866	2,16,558	1,66,259	2,41,187	3,02,299	4,00,525	1,72,432	15,70,126
Medium	2,631	8,592	6,584	9,426	11,229	35,541	11,294	85,297
Total	**4,95,013**	**23,73,058**	**15,17,455**	**21,21,545**	**25,62,258**	**40,31,643**	**61,07,641**	**182,59,780**

*Note: * Based on UAN and UDYAM registrations, ^Based on UDYAM registrations, Source: Development Commissioner Ministry of Micro, Small & Medium Enterprises (DCMSME), CRISIL Research*

State-wise category-wise registration of MSMEs

State	Cumulative MSME Registration	Share in overall MSME Registration	Growth in MSME Registrations (FY21-FY22)
Maharashtra	1,629,260.00	20%	50%
Tamil Nadu	855,740.00	11%	112%
Gujarat	648,231.00	8%	61%
Uttar Pradesh	632,258.00	8%	81%

Rajasthan	630,331.00	8%	112%
Karnataka	467,959.00	6%	106%
Madhya Pradesh	358,589.00	4%	120%
Bihar	311,631.00	4%	145%
Punjab	283,058.00	4%	112%
Haryana	282,866.00	4%	74%

Note: Based on UDYAM registrations, MSME Registration for FY21 is between the period July 2020 to March 2021, Source: Development Commissioner Ministry of Micro, Small & Medium Enterprises (DCMSME), CRISIL Research

Potential market for residential property backed secured MSME lending is estimated at Rs 22 trillion

The sheer size of the gap between the supply and demand of credit and the number of enterprises impacted indicates a veritable opportunity in MSME financing. There therefore exists a plethora of players – universal banks, small finance banks, traditional NBFCs, new age fintechs, MFIs, as well as local moneylenders – who try to meet the financing requirements of MSMEs by offering secured or unsecured loans straddling various tenures.

CRISIL Research has attempted to decipher the size of the potential opportunity in secured residential property-backed secured MSME lending (hereafter referred to as the Addressable market for secured MSME loans), using data, information and insights at a state-level pertaining to:

- Number of households from NSS 76th round (July 2018-December 2018)
- Self-employed non-agricultural households in both urban and rural areas from Periodic Labour Force Survey (PLFS) dated July 2019-June 2020
- Proportion of self-employed households, which are staying in their own pucca or semi-pucca home (which can be taken as a collateral by financiers) from NSS 76th round (July 2018-December 2018)

Based on our analysis and assumptions detailed in the chart below, small ticket size secured (SORP – Self occupied residential property) MSME lending market potential is estimated at Rs 22 trillion. Players such as Five Star Business Finance, Vistaar Financial, Veritas Finance and AU SFB currently operate in this market; our analysis indicates the Addressable Market available for these players. The top 5 states including UP, West Bengal, Bihar, Maharashtra and Tamil Nadu together account for almost half the addressable market.

While the latent market opportunity is indeed significant, we observe that there are not many formal financiers who cater to this segment and have built scale. This can be attributed to the high cost of serving the market and the time it takes to build expertise, the requirement of having a strong knowledge of the local market and regional dynamics, and the challenges associated with building a credit underwriting model for non-income proof customers and collections infrastructure.

Most small businesses in India do not maintain documents such as income proof, business registration, GST registration, income tax filings, and bank statements, making credit assessment challenging. To illustrate, as per GST council data, only 13.7 million enterprises across various size dimensions were registered under GST as of May 2022. Hence, these businesses have limited or no access to formal credit from banks and financial institutions due to the requisite documentation and stringent underwriting norms.

Examples of such businesses include provision stores, building materials stores, tea shops, vegetable vendors and others. The small business in manufacturing and services include small fabrication units, machine tools manufacturers (using lathe machines), tailors, saloons, Gym owners, vehicle service centres, etc.

Addressable market estimation methodology for secured MSME loans given to non-agriculture self-employed households with residential self-occupied property as collateral (FY21)

Source: National Sample Survey (NSS) 73rd round (July 2015 – June 2016) and NSS 76th round (July 2018 – December 2018), CRISIL Research

State wise split of addressable market

Top 15 states	Total Households ('000)	Total Non-agri Self Employed Households ('000)	Total Non-agri Self Employed Households - SORP ('000)	Total Non-agri Self Employed Households - SORP - Pucca + Semi Pucca ('000)	Overall MSME Addressable Market Size (Rs billion)
Uttar Pradesh	38,224	7,776	7,023	6,674	3,337
West Bengal	23,781	5,923	5,143	4,849	2,424
Bihar	19,960	4,498	4,270	3,953	1,976
Maharashtra	24,120	4,353	3,316	3,270	1,635
Rajasthan	13,384	3,075	2,743	2,685	1,342
Tamil Nadu	20,200	3,715	2,584	2,523	1,262
Gujarat	13,064	3,188	2,471	2,428	1,214

Madhya Pradesh	15,251	2,360	1,988	1,922	961
Andhra Pradesh	14,279	2,677	1,956	1,895	947
Kerala	8,577	1,988	1,795	1,789	895
Karnataka	14,928	2,740	1,822	1,786	893
Assam	6,740	1,965	1,702	1,660	830
Odisha	10,401	1,909	1,647	1,415	707
Punjab	5,922	1,636	1,415	1,409	705
Telangana	9,793	1,788	1,205	1,188	594
Others	32,483	6,585	5,317	5,180	2,590
All India	**2,71,105**	**56,115**	**46,397**	**44,624**	**22,312**

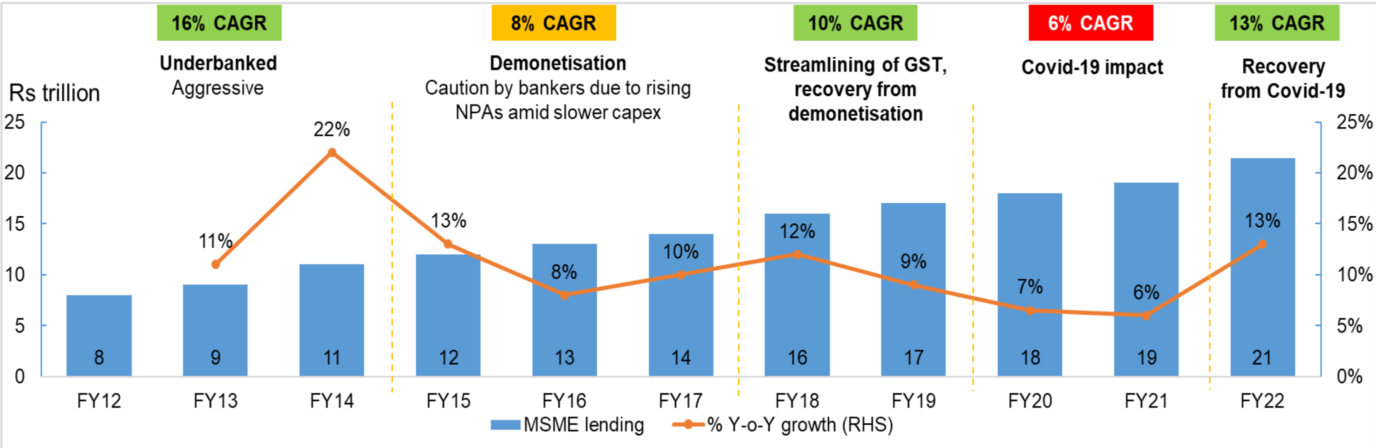
Note: States are arranged in order of Addressable market size, Source: National Sample Survey (NSS) 73rd round (July 2015 – June 2016) and NSS 76th round (July 2018 – December 2018), Periodic Labour Force Survey (PLFS) dated July 2019-June 2020, CRISIL Research

Overall MSME lending has grown at a CAGR of 10% in past decade; NBFC share estimated at 20%

CRISIL Research estimates the total size of MSME lending market across ticket sizes and various player groups (banks, NBFCs, small finance banks, and other formal lenders) to be around Rs 21 trillion as of March 2022. This market size includes loans taken by MSMEs across various constitution types (sole proprietorships, partnership firms, private and public limited companies, and co-operatives) and the ticket size spectrum, and includes loans extended in the name of the firm/entity/company as well as the individuals in case of micro enterprises or entrepreneurs.

CRISIL Research estimates loans to MSMEs to have grown at a CAGR of 10% during fiscal 2012 to fiscal 2022, which is similar to the nominal GDP growth in this period. This can be attributed to various events during this time span that has impacted MSMEs – demonetisation of high-value currency loans in November 2016, the implementation of GST subsequently, the economic slowdown in fiscal 2020 followed by the COVID-19 pandemic. In fiscal 2022, with recovery in economic activity, MSME lending also grew at a 13% on-year

MSME credit outstanding estimated at Rs 21 trillion as of March 2022; NBFCs enjoy 20% market share



Source: CRISIL Research estimates

Covid-19 pandemic led a heavy impact in the MSME industry in fiscal 2021 which was also seen in the first quarter of fiscal 2022. ECLGS schemes aimed to reduce the impact of the pandemic on the MSME sector. The first half of fiscal 2022 was also impacted by the second wave leading to lower disbursements to these MSMEs. This led to extension of the ECLGS scheme which cushioned the impact of pandemic. ECLGS scheme led by revival of economic activities, strong exports and domestic growth prompted MSME lending to grow at 13% in fiscal 2022.

NBFCs have managed to carve out a strong presence in MSME loans due to their focus on serving the needs of the customer segment, faster turnaround time, customer service provided and expansion in geographic reach. Over the years, the MSME portfolio of NBFCs have grown at a faster rate than the overall MSME portfolio at a systemic level. Thus, the share of NBFCs in total credit to MSMEs is estimated to have increased to ~20% at end of fiscal 2022 from 14% as of fiscal 2015. Going forward CRISIL Research expects the competitive positioning of NBFCs to remain strong, given their strong target customer and product focus.

ECLGS scheme has provided some relief to MSMEs hurt by the pandemic

Given the pain suffered by MSMEs due to the COVID-19 pandemic and the importance of MSMEs in India, the Indian government undertook several initiatives to support MSMEs and keep them afloat. This scheme provided much-needed liquidity to MSMEs that are known to have faced severe working capital crunch during downturns.

ECLGS 1.0

May 2020 to Aug 2020

- ECLGS was introduced by providing the MSMEs additional funding of up to Rs. 3 trillion in the form of a fully guaranteed emergency credit line.
- **Eligible entities**: All MSME borrower accounts with outstanding credit of up to Rs. 250 million as on February 29, 2020, which were less than or equal to 60 days past due as on that date and with an annual turnover of up to Rs. 1 billion
- In August 2020, the upper ceiling of outstanding credit was revised to Rs 0.5 billion and annual turnover to Rs 2.5 billion.

ECLGS 2.0

March 2021

- The Government extended ECLGS through ECLGS 2.0 for 26 sectors identified as stressed due to the COVID-19 pandemic by the Kamath Committee and the healthcare sector.
- **Eligible entities:** Entities with outstanding credit above Rs. 0.5 billion and not exceeding Rs. 5 billion as on February 29, 2020, which were less than or equal to 30 days past due as on February 29, 2020
- Annual turnover ceiling was removed from the eligibility criteria for ECLGS 1.0

ECLGS 3.0

Nov 2020

- Government extended the scope of ECLGS to cover business enterprises in Hospitality, Travel & Tourism, Leisure & Sporting sectors which had, as on February 29, 2020, total credit outstanding not exceeding Rs. 5 billion and were less than or equal to 60 days past due as on that date.
- The validity of ECLGS was extended up to June 30, 2021 or till guarantees for an amount of Rs. 3 trillion are issued.

ECLGS 4.0 **May 2021**	• ECLGS scope expanded to cover loans up to Rs 20 million to hospitals/nursing homes/clinics/medical colleges for setting up on-site oxygen generation plants with interest rate capped at 7.5% • Civil Aviation sector included under ECLGS 3.0 • Ceiling of Rs 5 billion of loan outstanding for eligibility under ECLGS 3.0 to be removed, subject to maximum additional ECLGS assistance to each borrower being limited to 40% or Rs 2 billion, whichever is lower. • Borrowers who had availed loans under ECLGS 1.0 of overall tenure of 4 years comprising of repayment of interest only during the first 12 months with repayment of principal and interest in 36 months can increase the tenure to 5 years (repayment of interest only for the first 24 months with repayment of principal and interest in 36 months thereafter) • Additional ECLGS assistance of up to 10% of the outstanding as on February 29, 2020 to borrowers covered under ECLGS 1.0
ECLGS 5.0 **June 2021**	• Additional allocation of Rs 1.5 trillion towards ECLGS scheme; limit of admissible guarantee and loan amount increased above existing level of 20% of outstanding on each loan • Sector wise details to be finalized as per evolving needs • Loan guarantee of Rs 1.1 trillion for COVID-affected sectors: INR 0.5 trillion towards health sector and INR 0.6 trillion towards other COVID-affected sectors, including travel and tourism stakeholders • Working capital/personal loans will be provided to people in tourism sector to discharge liabilities and restart businesses impacted due to COVID-19 • Loan guarantee of Rs 7,500 Crore for loans extended by SCBs to MFIs for on lending upto Rs 1.25 lakh to ~25 lakh customers; guarantee cover provided till March 31, 2022, or till guarantees for an amount of Rs 7,500 crore are issued, whichever is earlier

In September 2021, with a view to support various businesses impacted by the second wave of COVID-19 pandemic, the timeline for Emergency Credit Line Guarantee Scheme (ECLGS) has been extended till March 2022 or till guarantees for an amount of Rs 4.5 lakh crore are issued under the scheme, whichever is earlier. Further, in March 2022, the scheme was extended till March 2023 as was announced in Union Budget 2022-23. Out of the targeted amount of Rs 4.5 trillion, Rs 3.32 trillion has been sanctioned as of April 30, 2022, of which Rs 2.54 trillion has been disbursed

However, considering the entire universe of around 70 million MSMEs, the proportion of MSMEs that have benefitted remains limited at ~17% (11.6 million) of entire universe as on November 12, 2021. This is because the scheme covered only MSMEs having loan exposure to formal financiers as of February 2020. Among the eligible MSMEs, small and micro MSMEs have benefitted the most from ECLGS with 76% share in amount of guarantees issued to MSMEs and 93% share in number of guarantees issued as of November 12, 2021.

The cap of 14% on final interest rate charged to MSME customers for NBFCs meant that customers of many NBFCs, which typically charge more than 14% due to high operating costs and the relatively riskier profile of their borrowers, could not avail the benefits under the ECLGS scheme.

Modest response to restructuring of MSME loans

Post the Covid-19 pandemic, the central bank constituted a committee which identified 26 sectors for restructuring which included aspects related to leverage, liquidity and debt serviceability to be factored by the lending institutions while finalising resolution plans for borrowers. However, only those borrower accounts were eligible for resolution which were classified as standard, but not in default for more than 30 days with any lending institution as on March 1, 2020.

The RBI has, since 2019, permitted restructuring of temporarily impaired MSME loans (of size up to Rs 25 crore) under three schemes. While public sector banks have actively resorted to restructuring under all the schemes, participation by private sector banks was significant only in the restructuring scheme offered post Covid-19 in August 2020. Despite the restructuring, however, stress in the MSME portfolio remains high, especially in the case of public sector banks. For all scheduled commercial banks together, restructured loans as a proportion of MSME advances stood at 2.4 per cent as of December 2021. For NBFCs, the aggregate stressed assets (including GNPA as well as restructured assets) is estimated at 7.5-8.0% of MSMEs outstanding loan portfolio as of March 2021.

In May 2021, RBI announced a second loan restructuring program for small businesses for a loan amount up to Rs 25 crore to contain the second wave of COVID-19. The restructuring 2.0 is applicable to those who had not availed restructuring earlier, but the account should be standard as of 31st March 2021. In June 2021, the exposure limit for availing restructuring was enhanced from Rs 25 crore to Rs 50 crore.

Restructuring of MSME portfolios

	Aggregate Restructured Portfolio (Rs billion)	
Restructuring Scheme	Public sector banks (PSBs)	Private Sector Banks (PVBs)
Restructuring - January 2019 scheme	262	22
Restructuring - February 2020 scheme	59	14
Restructuring - August 2020 scheme	182	110
Restructuring – May 2021 scheme	303	159

Source: Financial Stability Report, June 2022

SMA distribution of MSME portfolio

	PSBs +PVBs				
(%)	0 days past due	SMA-0	SMA-1	SMA-2	GNPA
Mar-21	74.0	7.3	5.7	2.2	10.8
Jun-21	72.4	8.6	3.8	3.4	11.9
Sep-21	76.3	6.6	2.6	3.1	11.3
Dec-21	75.4	8.8	3.1	2.3	10.4
Mar-22	79.7	6.4	3.5	1.1	9.3

Note: PSB: Public Sector Banks, PVBs: Private Banks

Source: Financial Stability Report (June 2022)

Other measures included making available subordinated debt to MSMEs, equity infusion in export oriented MSMEs (launched in August 2021), steps undertaken to clear MSME dues within 45 days (announced in 26th July 2021) and disallowing global tenders in government tenders up to Rs. 2 billion to support the MSMEs amidst the pandemic. The government also announced the extension of the tenor of the schemes for MSMEs and other entities that are eligible for restructuring as per the Reserve Bank of India guidelines of May 2021.

Small Business Loans of less than Rs 10 lakhs ticket size

Small Business Loans has witnessed fastest growth within the overall MSME portfolio

In this section, we have classified all loans with ticket size lower than or equal to Rs 10 lakhs extended in the name of the individual to MSMEs, micro-entrepreneurs, and self-employed individuals irrespective of the turnover of the entity, as small business loans. Therefore, loans given out to enterprises or companies in the name of the entity and loans reported in the commercial bureau of credit information companies (CICs), even if they are below Rs 10 lakhs ticket size, are excluded from our market size.

The overall portfolio outstanding of small business loans (ticket size less than Rs. 10 lacs) given out by banks and NBFCs to be around Rs 1.86 trillion as of March 2022 and Rs. 1.95 trillion as of June 2022.

Small business loans grew at a fast pace with portfolio registering a CAGR of 22% over fiscal 2018 and 2022. Over the last few years, expansion in branch network, more data availability and government initiatives like GST, UDYAM, and increasing thrust to adoption of digital payments has led to increasing focus of lenders, especially the NBFCs, on the underserved segment of MSME customers including individuals and micro-entrepreneurs. Loan portfolio of Five Star Business Finance grew at a 50% CAGR over the same period (fiscal 2018 and 2022) to reach Rs 51 billion in fiscal 2022.

In fiscal 2021, the nationwide lockdown to contain the spread of the pandemic disrupted economic activity, hurt demand, impacted working capital needs and supply chain along with future investments and expansions. Domestic supplies and supplies from imports also suffered, affecting both, their availability and cost. Contractual and wage labour were also hit due to lower demand and layoffs. MSMEs and businesses in the sectors such as hotels, tourism, logistics, construction, textiles and gems and jewellery suffered the most during the first half of the fiscal. Businesses in the retail sector, especially those catering to daily usage goods and everyday cash and carry businesses such as grocery shops, fruits and vegetables sellers, etc., however, fared relatively better as their availability close to the residences of customers increased the demand for their services.

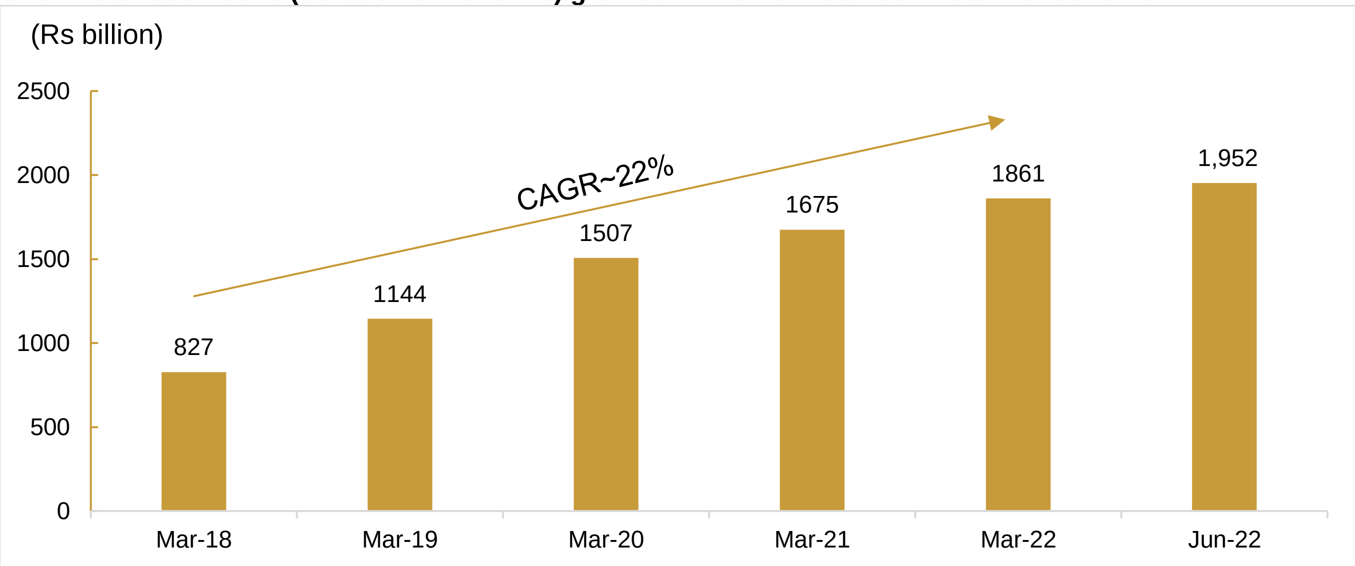
The second wave impacted the growth of credit for the MSME segment in the first quarter of fiscal 2022. This led to muted growth in the first half of fiscal 2022 on account of disruptions caused by localised lockdowns prompted by the pandemic. Government extended the ECLGS scheme then ending in June 2021 to September 2021(currently extended till March 31, 2023) which supported the sector to revive from the degrowth experienced in the first half of fiscal 2022. Strong economic recovery, higher exports, increased domestic demand and a mild third wave caused the MSME segment credit to grow at 13% in fiscal 2022. Banking MSME credit saw higher credit growth at 14.8% in fiscal 2022 compared to NBFCs at 6%. CRISIL Research expects the banks to continue to grow faster at 11-13% and NBFCs at 7-9% in fiscal 2023.

Although the demand for small business loan to meet liquidity and cash requirements existed in months of pandemic, lenders have been watchful and have been going slow on disbursements since the onset of the pandemic. Disbursements of small business loans of lower than Rs 10 lakhs ticket size grew by as much as 21% on a year-on-year basis to Rs 567 billion in fiscal 2022. Five Star Business Finance witnessed a 14% growth year on year in its loan portfolio in fiscal 2022 to touch Rs 51 billion as of March 2022.

Given the pain suffered by MSMEs due to the pandemic and the importance of MSMEs in India, the government undertook several initiatives to support MSMEs to keep them afloat, the most significant of which was the Rs 3 trillion emergency credit line guarantee scheme (ECLGS), which was aimed at pushing banks and NBFCs to extend further credit to MSMEs to meet their liquidity and funding needs with the government providing a back stop guarantee against such loans. This scheme clearly provided much-needed liquidity to MSMEs that are known to have faced severe working capital crunch during downturns. As of August 17, 2022, loans sanctioned have crossed Rs 3.67 trillion under the scheme. In June 2021, the government increased the overall admissible guarantee limit from Rs 3.0 trillion to Rs 4.5 trillion which was further increased to Rs 5 trillion in August 2022.

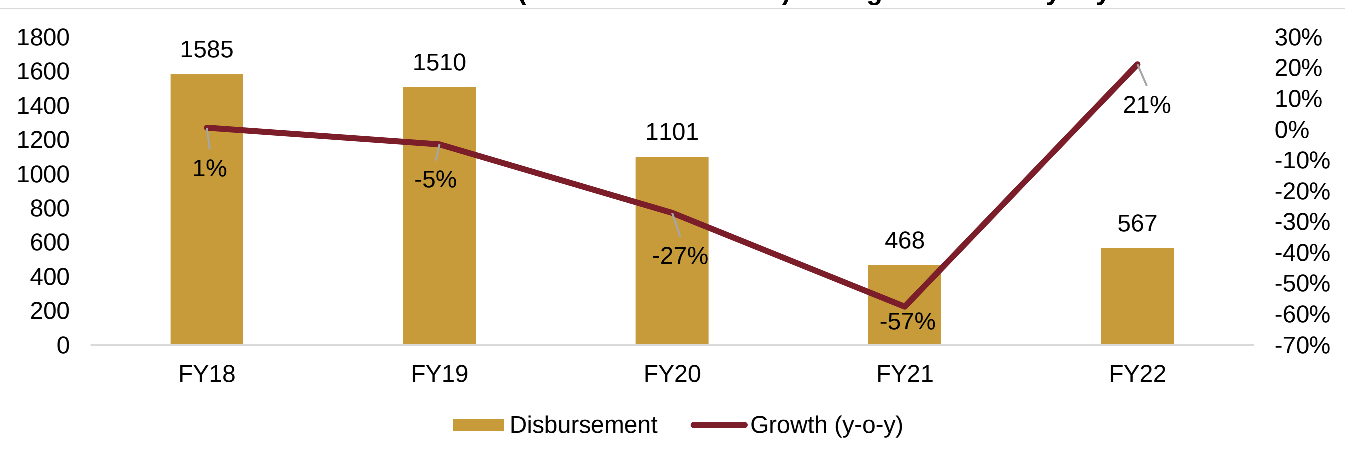
Other measures taken by the government to support MSMEs amidst the pandemic include making available subordinated debt to MSMEs, equity infusion in MSMEs, steps undertaken to clear MSME dues, and disallowing global tenders in government tenders up to Rs 2 billion to support the MSMEs.

Small Business Loans (ticket size <10 lakhs) grew at 22% CAGR between fiscal 2018 and 2022



Note: Above data includes business loans given to MSMEs upto Rs 10 lakhs ticket size and reported in consumer bureaus of CICs
Source: CRIF Highmark, CRISIL Research

Disbursements for small business loans (ticket size <10 lakhs) have grown at 21% y-o-y in fiscal 2022

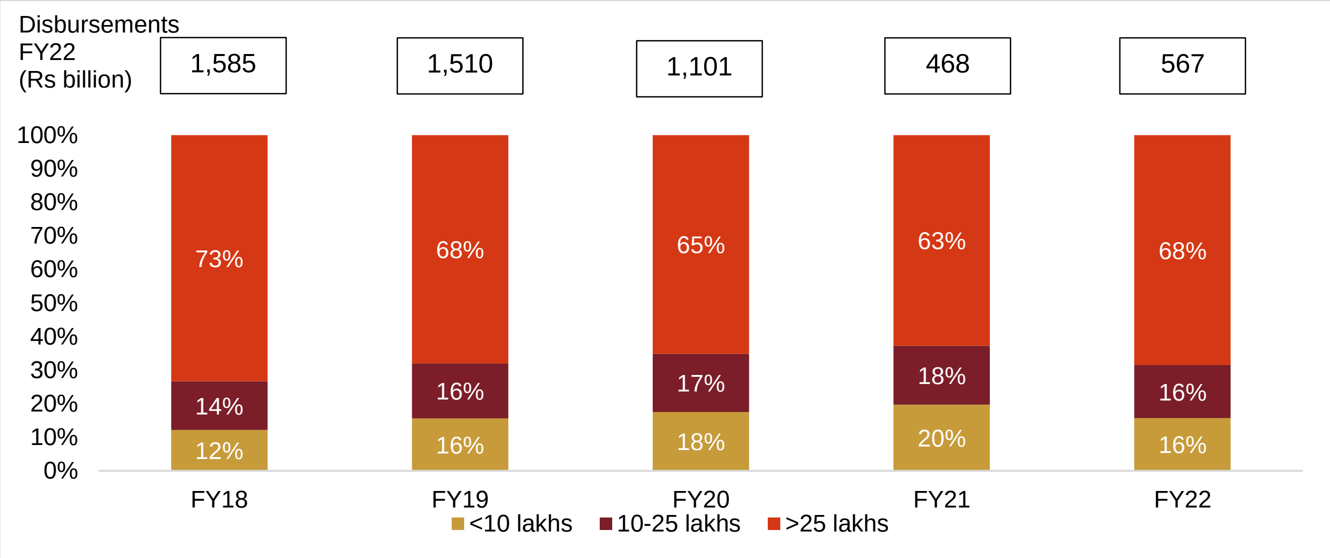


Note: Above data includes business loans given to MSMEs upto Rs 10 lakhs ticket size and reported in consumer bureaus of CICs
Source: CRIF Highmark, CRISIL Research

Small value business loans gained market share over the years

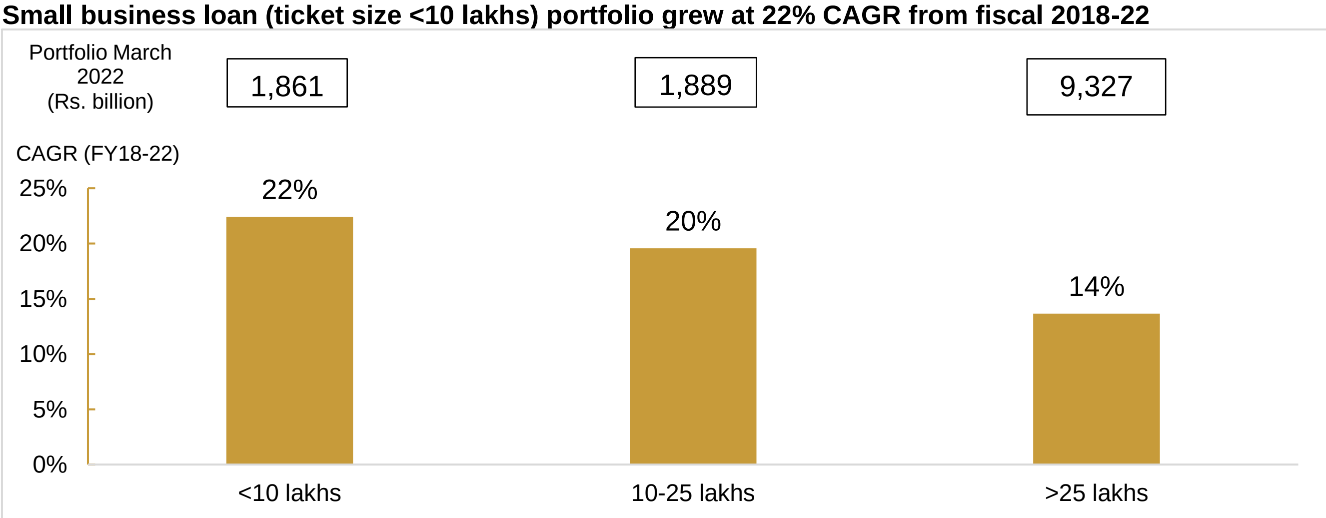
With increase in data availability and enhanced use of technology and experience gained across several cycles while lending to the same customer segment, lenders have increased focus on targeting the underserved segment within the small business loans market. This has led to a continued increase in share of smaller ticket size loans in the overall lending pie. The demand-supply gap, as outlined earlier, is also the highest in this segment, indicating significant business opportunities for financiers with a deep understanding of the target customer segment across focus geographies, ability to underwrite credit and the right unit economics. The market share of small business loans with ticket size less than Rs 10 lakhs in overall disbursements has increased from 12% in fiscal 2018 to 16% in fiscal 2022. Loans outstanding with relatively smaller ticket sizes have grown at a much higher pace, 22% from fiscal 2018-22, higher than larger ticket size loans between fiscal 2018 and fiscal 2022.

Share of smaller ticket size loans (ticket size <10 lakhs) in overall disbursements have increased in the last five years



Note: Above data includes business loans reported in consumer bureaus of CICs
Source: CRIF Highmark, CRISIL Research

Small business loan (ticket size <10 lakhs) portfolio grew at 22% CAGR from fiscal 2018-22

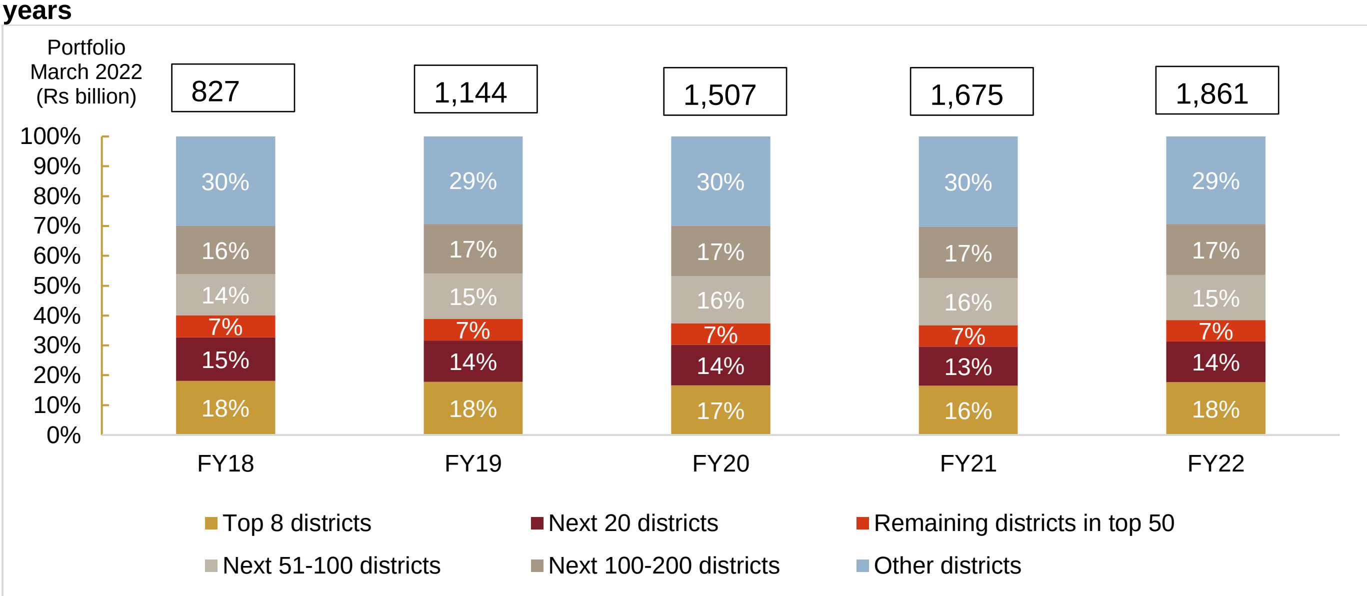


Note: Above data includes business loans reported in consumer bureaus of CICs
Source: CRIF Highmark, CRISIL Research

Penetration on small business loans is increasing in smaller cities

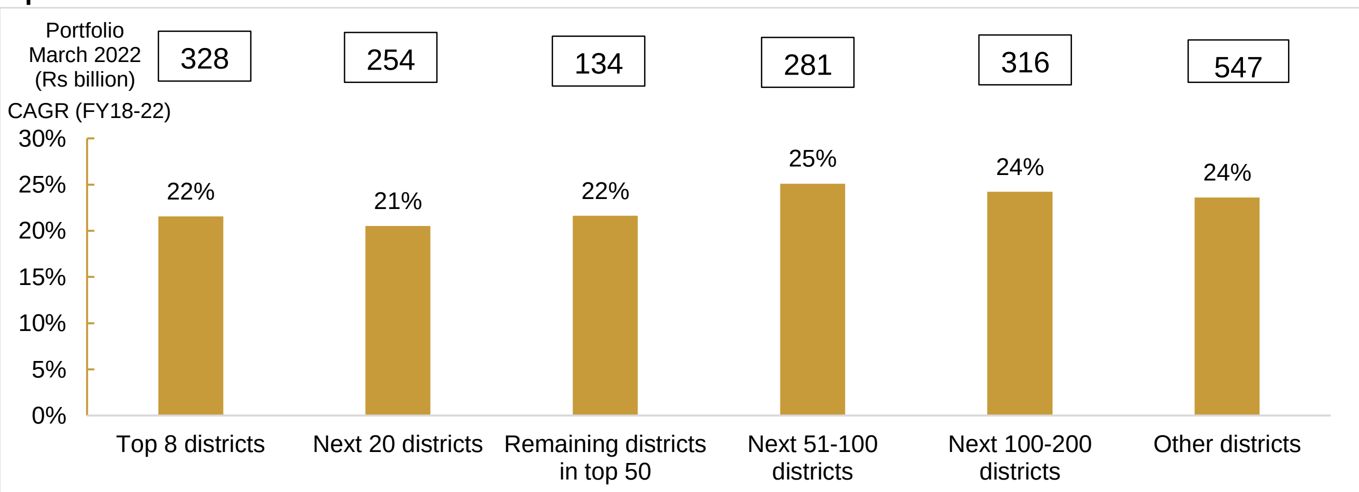
Over the years, share of smaller cities have increased in the small business loans segment owing to increasing penetration of financial services and players focussing on the underserved customer segment. Share of loans outside top 50 cities has increased from 60% in fiscal 2018 to 61% in fiscal 2022. Small business loans portfolio in smaller cities has grown at relative higher CAGR compared to that in top 50 cities.

Share of small business loans (ticket size <10 lakhs) portfolio in smaller cities increasing over past four years



Note: Above data includes business loans given to MSMEs upto Rs 10 lakhs ticket size and reported in consumer bureaus of CICs
1) Classification of districts is done based on population as per Census 2011.
2) Mumbai Metropolitan Region (MMR), National Capital Region (NCR), Bengaluru and Kanpur have each been considered as a district.
3) MMR includes Thane and Mumbai, NCR includes Delhi, Gurugram, Gautam Buddha Nagar, Ghaziabad and Faridabad, Bengaluru includes Bangalore Urban and Bangalore Rural, Kanpur includes Kanpur Nagar and Kanpur Dehat
Source: CRIF Highmark, CRISIL Research

Small business loans (ticket size <10 lakhs) portfolio in smaller cities grew at a higher CAGR than that in top 50 cities



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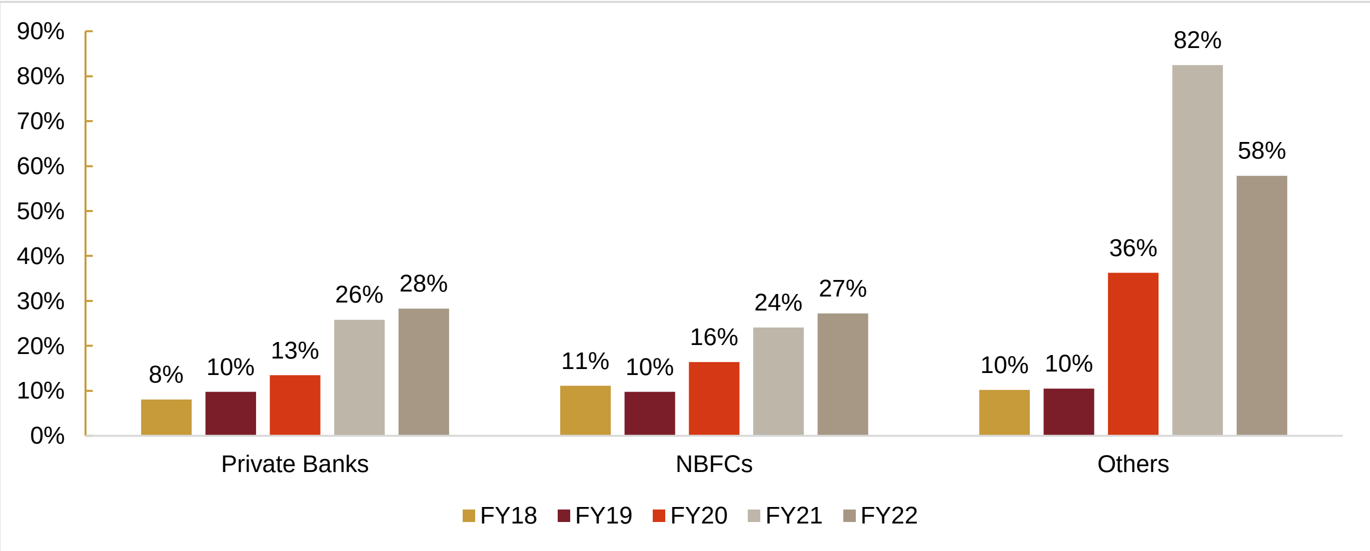
Source: CRIF Highmark, CRISIL Research

Share of new to credit customers has been increasing in small business loans segment

Share of new to credit (NTC) customers has increased over the years, indicating increasing penetration of small business loans. Overall, share of new to credit customers in small business loan segment with ticket size less than Rs 10 lakhs has increased from 9% in fiscal 2017 to 25% in fiscal 2020. Among player groups, public sector banks have highest share of NTC customers followed by NBFCs. Growth of new to credit customers is much higher in small business loans of ticket size less than Rs 10 lakhs compared to that of ticket size more than Rs 10 lakhs across players. In fiscal 2022, the proportion of NTC customers in small business loans segment is estimated to have further increased to around 27% for NBFCs.

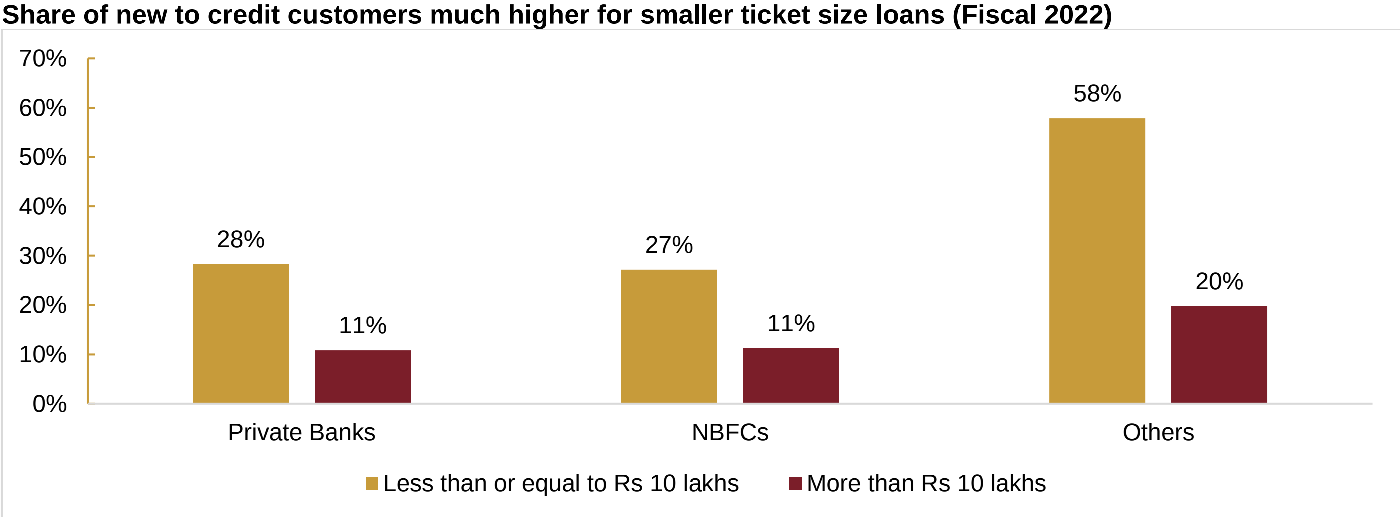
Share of new to credit customer increasing across players for small busines loans (ticket size <10 lakhs)



Note: Above data includes business loans reported in consumer bureaus of CICs, NTC defined as loans with borrower vintage <= 12 months, Others includes player groups like Small Finance Banks, Foreign Banks, Regional Rural Banks

Source: CRIF Highmark, CRISIL Research

Share of new to credit customers much higher for smaller ticket size loans (Fiscal 2022)



NTC defined as loans with borrower vintage <= 12 months

Note: Above data includes business loans reported in consumer bureaus of CICs

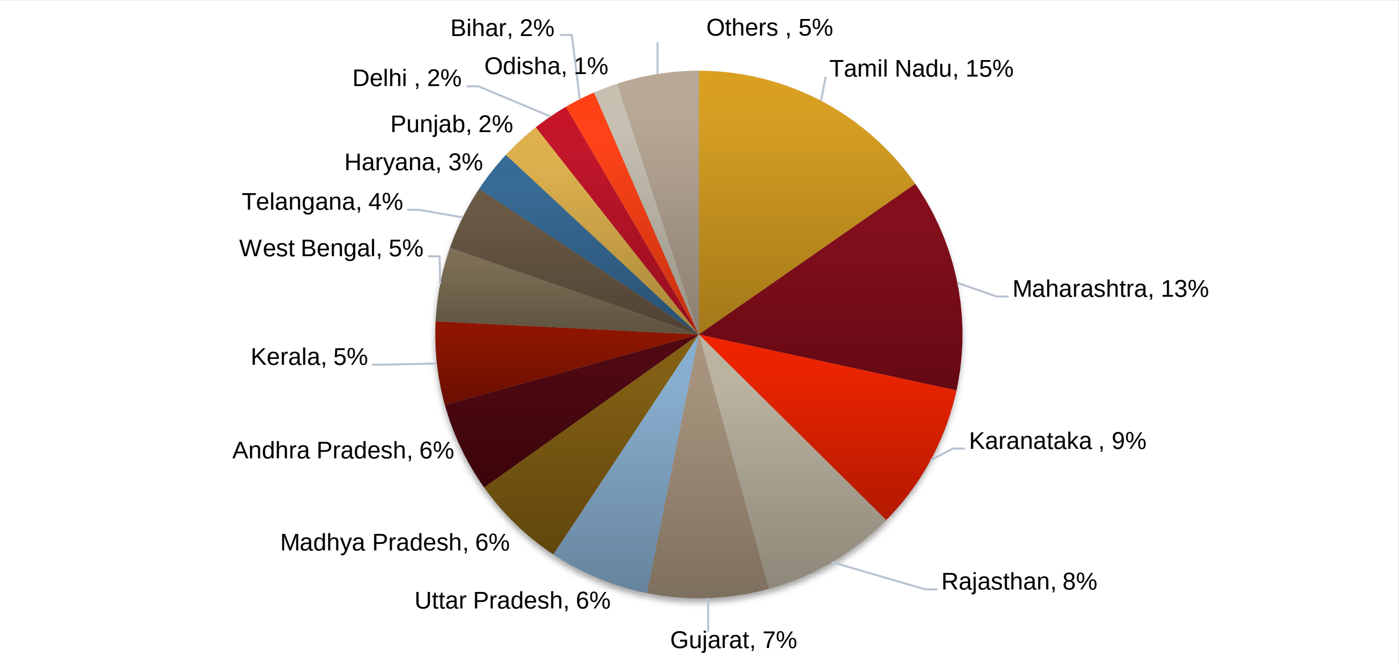
Source: CRIF Highmark, CRISIL Research

State-wise analysis

The small business loans segment has been growing strongly with a four-year CAGR of 22% between fiscal 2018 and 2022. However, there are wide variations across states and within various districts in the same state as well, which indicates latent opportunity for offering loans to unserved or underserved customers. Based on the value of small business loans lower than Rs 10 lakhs ticket size outstanding, the top 16 states accounted for 95% of the market size in this segment as of June 2022. Tamil Nadu tops the list with the highest share of 15%, followed by Maharashtra (13%), Karnataka (9%), Rajasthan (8%) and Gujarat (7%).

In the last four years, among the top 16 states, small business loans outstanding has grown at the fastest clip in West Bengal, which exhibited growth of 33% CAGR, followed by Andhra Pradesh (30%) and Madhya Pradesh (29%).

Top 16 states account for 95% of small business loans (ticket size <10 lakhs) portfolio (June 2022)



Note: Above data includes business loans given to MSMEs upto Rs 10 lakhs ticket size and reported in consumer bureaus of CICs

Source: CRIF Highmark, CRISIL Research

Amongst player groups, the share of NBFCs is highest at 73% in Rajasthan followed by Telangana (58%), and Andhra Pradesh (55%) in the top 16 states.

State-wise analysis of small business loans as of June 2022 (ticket size <10 lakhs)

State	No of districts	Small Business Loans outstanding as of June 2022 (Rs billion)	Share of state in small business loans market (June 2022)	Growth in small business loans outstanding (CAGR FY18-FY22)	Top 5 districts based on small loans outstanding	Share of top 5 districts in small business loans outstanding	Share of NBFCs in small business loans market (June 2022)
Tamil Nadu	32	298	15%	21%	Kancheepuram ,Thiruvallur ,Chennai ,Coimbatore ,Salem	37%	43%
Maharashtra	35	254	13%	22%	Pune ,Thane ,Mumbai ,Nashik ,Mumbai Suburban	52%	48%

Karanataka	30	176	9%	25%	Bangalore ,Mysore ,Belgaum ,Tumkur ,Davanagere	50%	38%
Rajasthan	33	162	8%	25%	Jaipur ,Ajmer ,Bhilwara ,Jodhpur ,Alwar	44%	73%
Gujarat	33	145	7%	20%	Ahmadabad ,Surat ,Rajkot ,Vadodara ,Gandhinagar	58%	54%
Uttar Pradesh	75	120	6%	17%	Ghaziabad ,Lucknow ,Agra ,Meerut ,Gautam Buddha Nagar	32%	43%
Madhya Pradesh	51	114	6%	29%	Indore ,Bhopal ,Ujjain ,Dewas ,Dhar	43%	54%
Andhra Pradesh	13	108	6%	30%	East Godavari ,Visakhapatnam ,Krishna ,Guntur ,West Godavari	63%	55%
Kerala	14	99	5%	29%	Ernakulam ,Malappuram ,Kottayam ,Thiruvananthapuram ,Thrissur	60%	21%
West Bengal	19	88	5%	33%	Kolkata ,North Twenty Four Parganas ,South Twenty Four Parganas ,Barddhaman ,Nadia	49%	27%
Telangana	10	77	4%	21%	Hyderabad ,Rangareddy ,Karimnagar ,Warangal ,Nalgonda	77%	58%
Haryana	21	51	3%	18%	Faridabad ,Gurgaon ,Panipat ,Karnal ,Yamunanagar	50%	52%
Punjab	22	48	2%	14%	Ludhiana ,Jalandhar ,Amritsar ,Patiala ,Sahibzada Ajit Singh Nagar	61%	45%
Delhi	9	43	2%	17%	North West ,West ,South ,South West ,East	78%	53%
Bihar	38	37	2%	20%	Patna ,Muzaffarpur ,Gaya ,Purba Champaran ,Samastipur	38%	30%
Odisha	30	29	1%	26%	Khordha ,Cuttack ,Ganjam ,Baleshwar ,Puri	50%	29%
Assam	27	23	1%	20%	Kamrup Metropolitan ,Nagaon ,Kamrup ,Cachar ,Sonitpur	38%	16%
Chhattisgarh	27	21	1%	28%	Raipur ,Durg ,Bilaspur ,Janjgir - Champa ,Rajnandgaon	63%	41%
Uttarakhand	13	16	1%	11%	Dehradun ,Hardwar ,Udham Singh Nagar ,Nainital ,Garhwal	91%	49%
Jharkhand	24	15	1%	28%	Ranchi ,Purbi Singhbhum ,Dhanbad ,Hazaribagh ,Bokaro	65%	31%
Himachal Pradesh	12	6	0%	5%	Kangra ,Solan ,Shimla ,Mandi ,Una	71%	25%
Puducherry	4	5	0%	20%	Puducherry, Karaikal, Yanam, Mahe	100%	32%
Tripura	4	3	0%	77%	West Tripura, South Tripura, North Tripura, Dhalai	100%	11%

Goa	2	3	0%	12%	North Goa, South Goa	100%	17%
Jammu & Kashmir	22	2	0%	-6%	Jammu, Anantnag ,Srinagar ,Reasi ,Pulwama	77%	22%
Manipur	9	2	0%	32%	Imphal West ,Imphal East ,Thoubal ,Tamenglong ,Bishnupur	78%	12%
Chandigarh	1	2	0%	6%	Chandigarh	100%	54%
Meghalaya	9	1	0%	8%	East Khasi Hills ,West Garo Hills ,West Jaintia Hills ,Ribhoi ,West Khasi Hills	95%	8%
Nagaland	11	1	0%	23%	Dimapur ,Kohima ,Mokokchung ,Wokha ,Zunheboto	98%	6%
Dadra & Nagar Haveli	1	1	0%	19%	Dadra & Nagar Haveli	100%	64%
Sikkim	4	1	0%	30%	East District, West District, South District, North District	100%	6%
Arunachal Pradesh	14	0	0%	41%	Kurung Kumey ,Lower Subansiri ,Papum Pare ,West Kameng ,Tawang	76%	9%
Mizoram	8	0	0%	48%	Aizawl ,Lunglei ,Champhai ,Kolasib ,Serchhip	90%	6%
Daman & Diu	2	0	0%	15%	Daman, Diu	100%	54%
Andaman & Nicobars	3	0	0%	16%	South Andaman , North & Middle Andaman , Nicobars	100%	19%
Lakshadweep	1	0	0%	76%	Lakshadweep	100%	17%

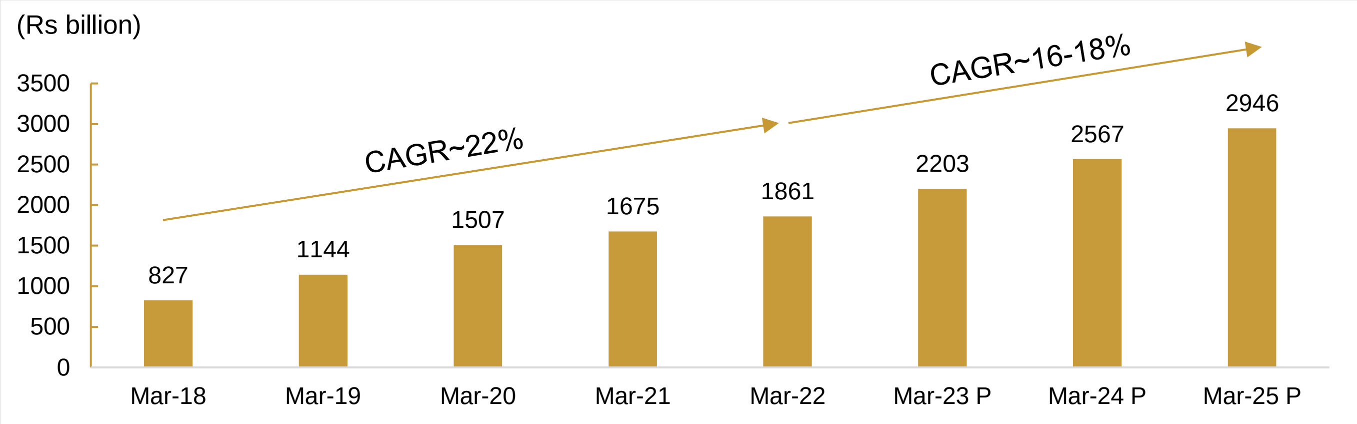
Note: Above data includes business loans given to MSMEs upto Rs 10 lakhs ticket size and reported in consumer bureaus of CICs. Number of districts are as reported in the bureau data.
Source: CRIF Highmark, CRISIL Research

Small business loans will continue to grow at a strong pace

There is a huge demand supply gap in small business loan segment. With increasing presence of small business loans in smaller cities and rising focus of lenders on underserved target customer segment, loan portfolio is expected to see a strong growth in future. According to RBI, size-wise credit to large industry grew by 5.2% in July 2022, against a contraction of 3.8% a year ago. Medium enterprises recorded a credit growth of 36.8% in July 2022 as compared to 59% last year, while credit growth to micro and small enterprises accelerated to 28.9% in July 2022, from 10.5% during the same period in the last year.

In the short term, rise in economic activity, higher working capital requirement due to rising input costs is likely to cause an uptick in the credit demand. Over the coming fiscals, CRISIL Research expects the small business loans portfolio to grow at 16-18% CAGR over fiscal 2022 and 2025 aided by increasing lender focus and penetration of such loans, enhanced availability of data increasing lender comfort while underwriting such loans, enhanced use of technology, newer players entering the segment, and continued government support.

Small Business Loans (ticket size <10 lakhs) to grow at 16-18% CAGR between fiscal 2022 and 2025



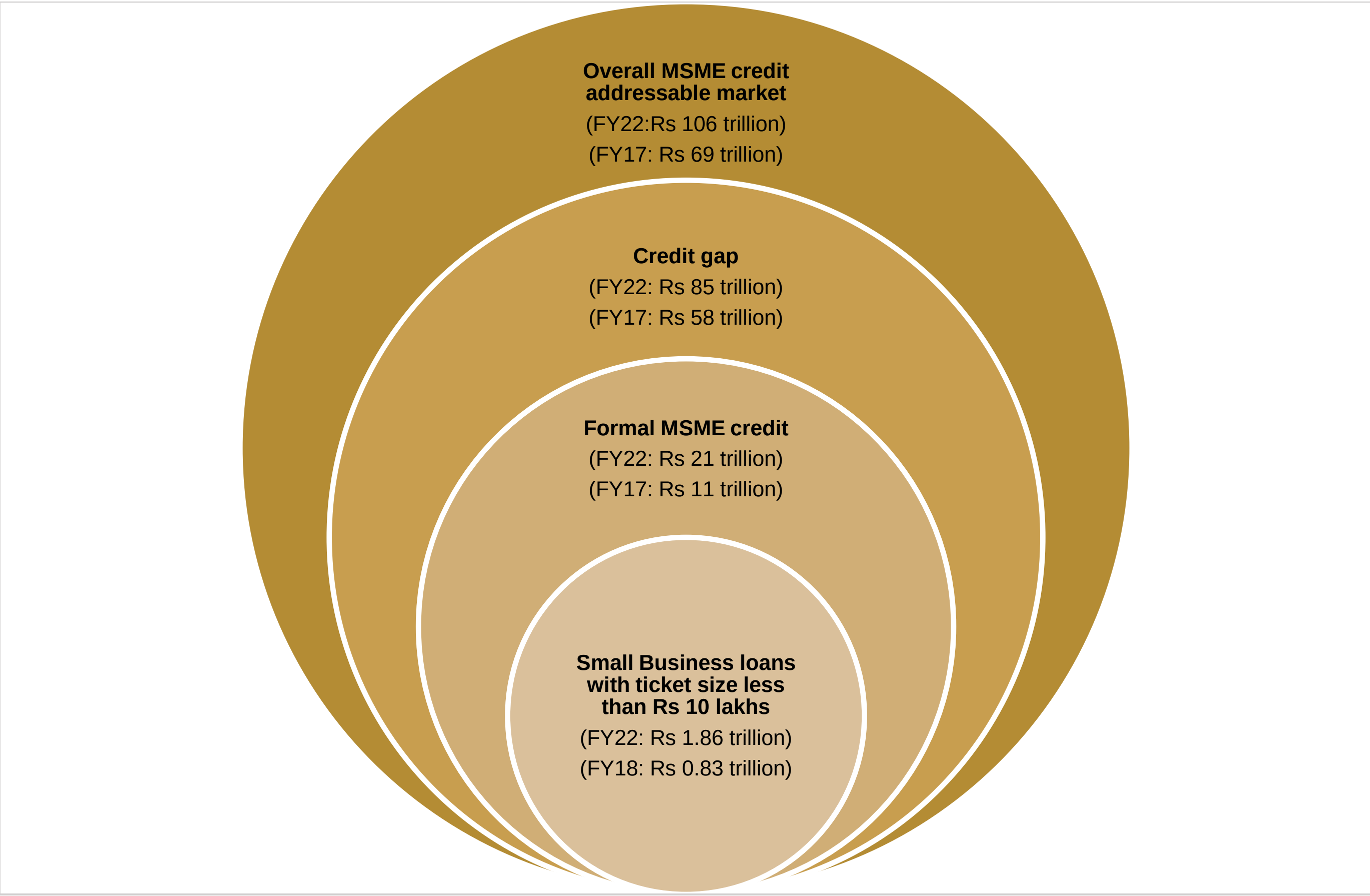
Note: Above data includes business loans given to MSMEs upto Rs 10 lakhs ticket size and reported in consumer bureaus of CICs, P-Projected
Source: CRI Highmark, CRISIL Research

Growth drivers

High credit gap in the target customer segment

Less than 15% of approximately 70 million odd MSMEs have access to formal credit in any manner as of March 2022. High risk perception and the prohibitive cost of delivering services physically have constrained traditional institutions' ability to provide credit to underserved or unserved MSMEs and self-employed individuals historically. As a result, they resort to credit from informal sources. This untapped market offers huge growth potential for financial institutions. As stated earlier, the credit gap was estimated at around Rs 58.4 trillion as of 2017 *(Source: IFC report named Financing India's MSMEs released in November 2018)* and is estimated to have widened further to around Rs 85 trillion as of fiscal 2022.

Small Business Loans with ticket size less than Rs 10 lakhs account for only 9% of formal MSME credit indicating huge opportunity



Note: Overall formal MSME credit given above includes all kinds of secured and unsecured loans given to MSMEs across ticket sizes by organised lenders.
Source: MSME Ministry Annual report for FY21, IFC report on Financing India's MSMEs dated November 2018, CRIF Highmark, CRISIL Research

Increased data availability and transparency

With increased digital initiatives by the MSMEs, the shift towards their formalisation and digitisation has created a plethora of data points for lenders that would help improve the efficacy of credit assessment and gradually enable provision of credit to hitherto underserved customer segments. For example, the quantum of retail digital payments has catapulted from Rs 140 trillion in fiscal 2017 to Rs 457 trillion in fiscal 2022. Within UPI, the quantum of person-to-merchant payments has zoomed from Rs 6.2 trillion in fiscal 2021 to Rs 15.9 trillion in fiscal 2022. This increase has created a digital footprint of customers, which can be potentially used for credit decision making, along with other relevant parameters such as customer demographics, business details, credit score, and personal situation of the borrower.

Multiple data points can be used for credit assessment

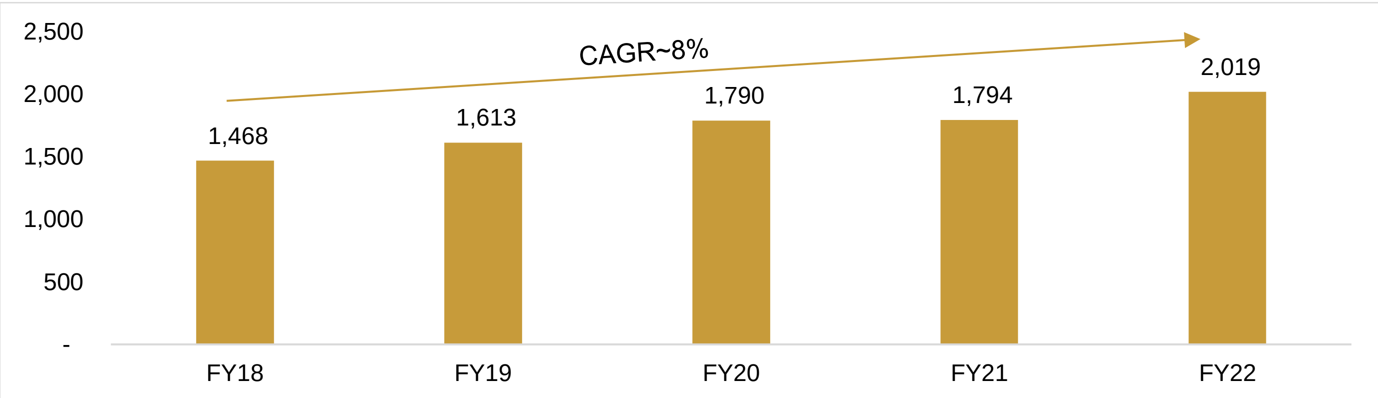
Source: CRISIL Research

Growth in branch network of players in small business loans segment

Over past few years, players offering small business loans segment have expanded their branch network with the intent to serve a larger customer base. To illustrate, the cumulative branch network of five small business lenders (Five Star, Shriram City Union, Vistaar, Veritas and Aye) has expanded at 8% CAGR between fiscal 2018 and 2022, even while the NBFC universe and the economy were impacted by the IL&FS crisis, a slowdown in growth in fiscal 2020 and the Covid-19 pandemic. Five Star Business Finance witnessed a CAGR of 23% over the same period; it had 300 branches as of March 2022.

In the future also, we expect lenders with a strong focus on MSME lending and healthy competitive positioning to continue to invest in branch expansion. With increasing branch network, customer acquisition and credit penetration of small business loans will also increase.

Number of branches have grown at 8% CAGR over fiscal 2018 and 2022



Note: The above data includes branches for Five Star Business Finance, Shriram City Union Finance, Vistaar Finance, Veritas Finance and Aye Finance, Source: Company Reports, CRISIL Research

Reduction in risk premiums due to information asymmetry

In the absence of reliable information about small businesses, it becomes difficult for lenders to assess the creditworthiness of the borrower. Hence, lenders often charge a credit risk premium from these customers, leading to higher interest rates. By leveraging technology and using a combination of traditional data (bureau data, financial statements, credit score), non-traditional data (payments, telecom, provident fund contribution and psychometric data), and government data (Aadhaar, GST), lenders would be able to gain greater insight into their customers' data, thereby increasing the accuracy of customer assessments. This would reduce the level of asymmetry in information and could lower the credit risk premium over a period.

Increasing competition with entry of new players and partnerships between them

More players in consumer-facing businesses with a repository of data (such as e-commerce companies and payment service providers) are expected to enter the lending business, intensifying competition. For example, In June 2018, Amazon India launched a platform for lenders and sellers, wherein sellers can choose loan offers from various lenders at competitive rates. In August 2021, Meta (earlier known as Facebook) partnered with Indifi Technologies to provide loans to small businesses that advertise on its platform. Incumbent traditional lenders will increasingly leverage the network of their partners and/or digital ecosystem to cross-sell products to existing customers, tap customers of other lenders, and also cater to new-to-credit customers. This will expand the market for MSME loans.

Reduction in TAT and increased use of technology

With the availability of multiple data points and technological advancement, TAT for lending to MSMEs has been continuously declining. This too will drive the demand for MSME loans.

Government initiatives

Relaxation in the threshold under SARFAESI Act from Rs 5 million to Rs 2 million for NBFCs

In the Union Budget 2021-22, presented by the Finance Minister, for NBFCs with a minimum asset size of ₹100 crore, the minimum loan size eligible for debt recovery under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI) Act, 2002 was proposed to be reduced from the existing level of Rs 5 million to Rs 2 million. The objective of this move is to improve credit discipline while continuing to protect the interest of small borrowers. This relaxation is expected to facilitate recovery from stressed books, help the NBFCs to improve their ability to recover smaller loans and strengthen their overall financial health. More importantly, it acts as a deterrent to default and enhances the enforceability of collateral for players focused on the medium ticket size LAP segment with loans of Rs 20-50 lakhs.

Inclusion of retail and wholesale trade under MSME category

In July 2021, the Ministry of Micro, Small and Medium enterprises decided to include Retail and Wholesale trade as MSMEs for the purpose of Priority Sector Lending and they would be allowed to be registered on UDYAM Registration Portal. The move is structurally positive from long-term perspective, as it will enable entities operating in the segment to register on Government's UDYAM portal, participate in government tenders and also avail financing options/ benefits available to the category. This move will also aid in the formalisation of India's retail trade and enable financial support to small and mid-sized retail businesses. By widening the scope of MSME to cover wholesale as well as retail trade, this move also creates an additional opportunity for MSME lenders to increase their penetration and business.

Credit Guarantee Fund Scheme extended to cover NBFCs

One of the major reasons why MSMEs are credit-starved is the insistence by banks or financial institutions for the provision of collateral against loans. Collaterals are not easily available with such enterprises, leading to a high-risk perception and higher interest rates for these MSMEs. In order to address this issue, the government launched the Credit Guarantee Fund Scheme under the aegis of the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) in order to make collateral-free credit available to micro and small enterprises.

In January 2017, the scheme was extended to cover systemically important NBFCs as well. Key eligibility criteria for this scheme are:

1) NBFCs should be registered with RBI and meet specified prudential norms.

2) the NBFC should have made a profit for the three preceding fiscals at the time of enrolment.

3) the NBFC should be lending to micro and small enterprises with minimum 5 years of lending experience, minimum Rs 100 crore of MSE loan portfolio, NPA level below 5% for MSE portfolio and average recovery ratio of 90% for preceding three fiscals at the time of enrolment and

4) it should have long-term credit rating of at least BBB. The overall limit under the scheme has also been enhanced to Rs 20 million.

Guarantees approved under CGTMSE

Year	Number of guarantees approved	Amount of guarantees approved (Rs billion)
FY19	435,520	302
FY20	846,650	459
FY21	835592	369
FY22	717020	561

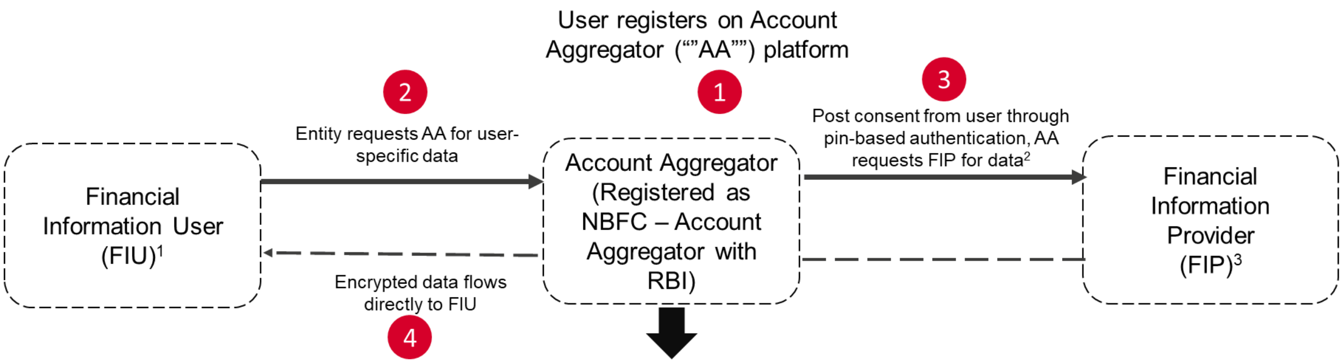
Source: CGTMSE, CRISIL Research

Government initiatives addressing structural issues in the MSME market

The government has unveiled a number of initiatives aimed at addressing some of the structural issues plaguing small business lending segment. These include granting licenses to account aggregators, the Pradhan Mantri Mudra Yojana (PMMY), unveiling Trades Receivables Discounting System (TReDS) platforms and the implementation of GST.

Licensing account aggregators

The RBI launched the account aggregator system on September 2, 2021, which has the potential to transform the MSME finance space once there is widespread adoption amongst the lending community. Four account aggregators also announced the launch of their apps on the same day which include OneMoney, FinVu, CAMSFinServ and NADL (NESL Asset Data Limited). Account aggregators are essentially non-banking financial companies, licensed by RBI, that act as an intermediary to collect and consolidate data from all Financial Information Providers (FIP) that hold users' personal financial data like banks and share that with Financial Information Users (FIU) like lending agencies or wealth management companies that provide financial services.These account aggregators would provide granular insights to lenders into customers' financial assets and their borrowing history centrally, based on customer consent. Inclusion of additional data such as electricity bill payments and mobile recharges/bill payment data under the purview of account aggregators would further enhance its utility.



1. FIU is any registered entity[4] which requires access to user data; once registered as an FIU, the entity will have access to data of all users registered on AAs (basis their consent); the consent will be valid for a period of time as permitted by the user
2. The user has complete control over his/her available FIP data which can be shared with FIU; for example, a user who has three bank accounts can decide to share data from only one bank account
3. The current details that can be sourced through AA portal/app are bank accounts, deposits, mutual funds, insurance policies and pension funds

Note: [4] Registered with any one of the regulators – SEBI, RBI, IRDAI, PFRDA

Source: CRISIL Research

Some of the other government and regulatory initiatives are detailed below:

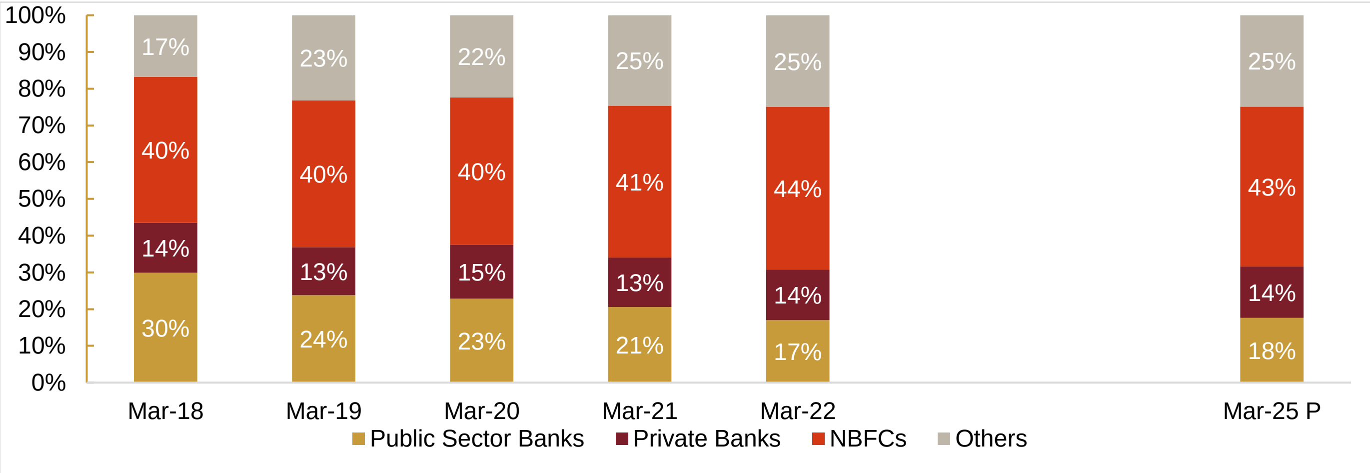
- UDYAM registration: Paperless and online registration process for MSMEs with an aim to promote ease of doing business.
- Stand-up India: It facilitates bank loans between ₹ 1 million and ₹ 10 million to at least one scheduled caste or scheduled tribe borrower and at least one-woman borrower per bank branch for setting up a greenfield enterprise.
- Make in India: Launched with an intention to make India a global manufacturing hub, which in turn will provide employment to numerous youths in the country
- Mudra loans: To fulfil funding requirement of MSMEs who were earlier left out by financial institutions; credit guarantee support also offered to financiers.
- 59-minute loan: Online marketplace that provides in-principle approval to MSME loans up to ₹ 10 million in 59 minutes.
- Unified Payments Interface 2.0 (UPI 2.0): Real-time system for seamless money transfer from account
- Trade Receivables Discounting System (TReDS): Institutional mechanism to facilitate financing of trade receivables of MSMEs from corporates and other buyers through multiple financiers.
- Factoring to support more participation from NBFCs: In an amendment to Factoring Regulation Act, 2011, the Lok Sabha passed the Factoring Regulation (Amendment) Bill in July 2021.

NBFCs increasing their presence in the small business loans segment

NBFCs have managed to carve out a strong presence in small business loans due to their focus on serving the needs of the customer segment, faster turnaround time, customer service provided and expansion in geographic reach. As of fiscal 2022, the cumulative market share of NBFCs in small business loans of less than Rs 10 lakhs ticket size outstanding is estimated to be around 44%.

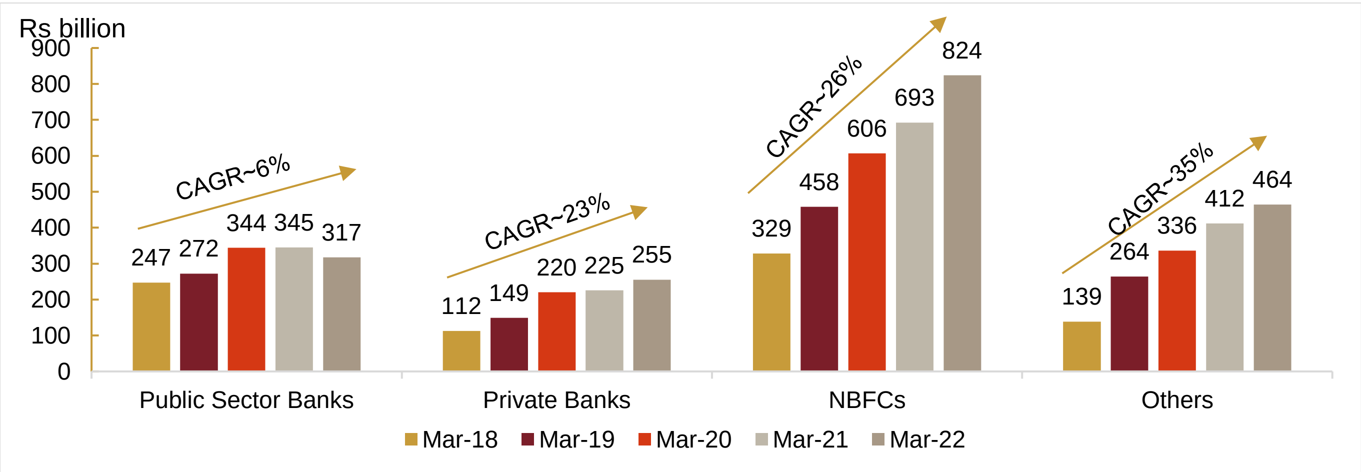
Over the years, the small business loan portfolio of NBFCs have grown at a faster rate than the overall small business loan portfolio at a systemic level, clocking a CAGR of 26% over fiscals 2018 and 2022. Market share of NBFCs remained stable between fiscal 2018 and 2019 due to demonetisation and the NBFC liquidity crisis but has increased subsequently. The cumulative market share of NBFCs increased by 4 percentage points over fiscals 2018-2022. Going forward, we expect NBFCs to continue being a major player in small business loans of less than Rs 10 lakhs ticket size.

NBFCs continue to be a major player in small business loans less than Rs 10 lakhs ticket size



Note: (1) Above data includes business loans given to MSMEs upto Rs 10 lakhs ticket size and reported in consumer bureaus of CICs, (2) Others include small finance banks, foreign banks, co-operative banks and regional rural banks, (3) P-Projected
Source: CRIF Highmark, CRISIL Research

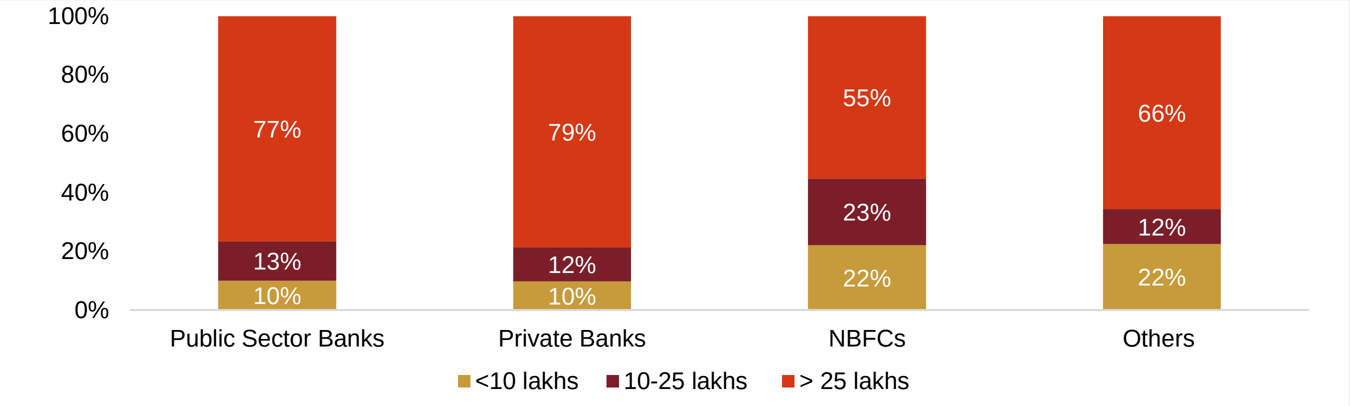
NBFCs have grown at faster pace compared to PSBs and private banks in small business loans less than Rs 10 lakhs ticket size



Note: (1) Above data includes business loans given to MSMEs upto Rs 10 lakhs ticket size and reported in consumer bureaus of CICs, (2) Others includes player groups like Small Finance Banks, Foreign Banks, Regional Rural Banks
Source: CRIF Highmark, CRISIL Research

NBFCs have high share of small business loans disbursed (ticket size less than Rs 10 lakhs) compared to private sector banks and public sector banks in fiscal 2022. These banks lend to more organised and formal customers with proper income documentation and credit profile. In contrast, NBFCs lend to borrowers who may not have documented income proof, and therefore, NBFCs rely greatly on their deep understanding of the target customer segment and ability to assess income and cash flows of the customers through personal discussions or other alternate data for underwriting loans.

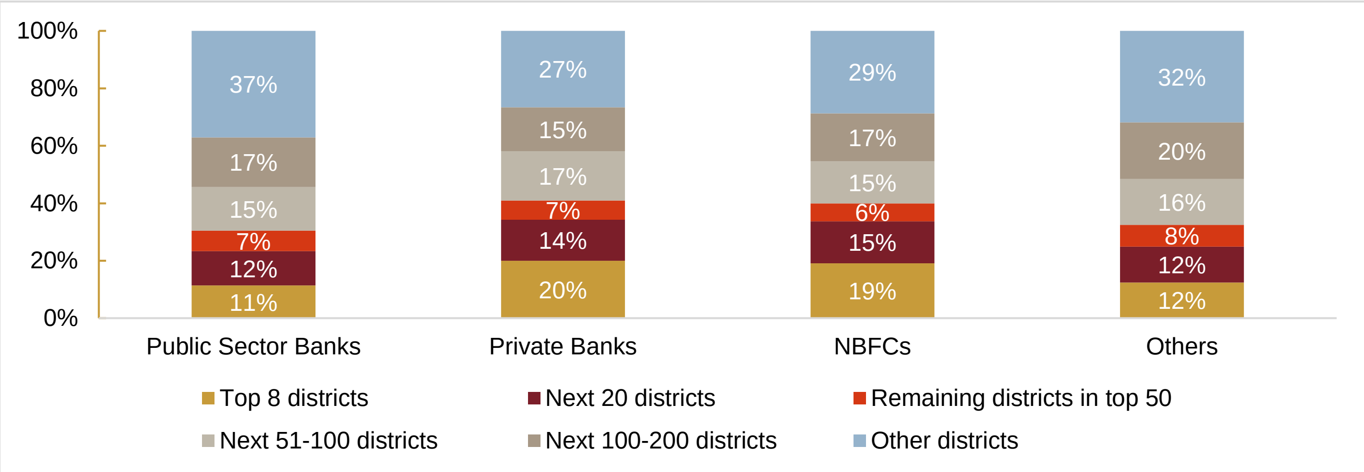
NBFCs have one of the highest share of disbursements towards small business loans among other lenders in fiscal 2022



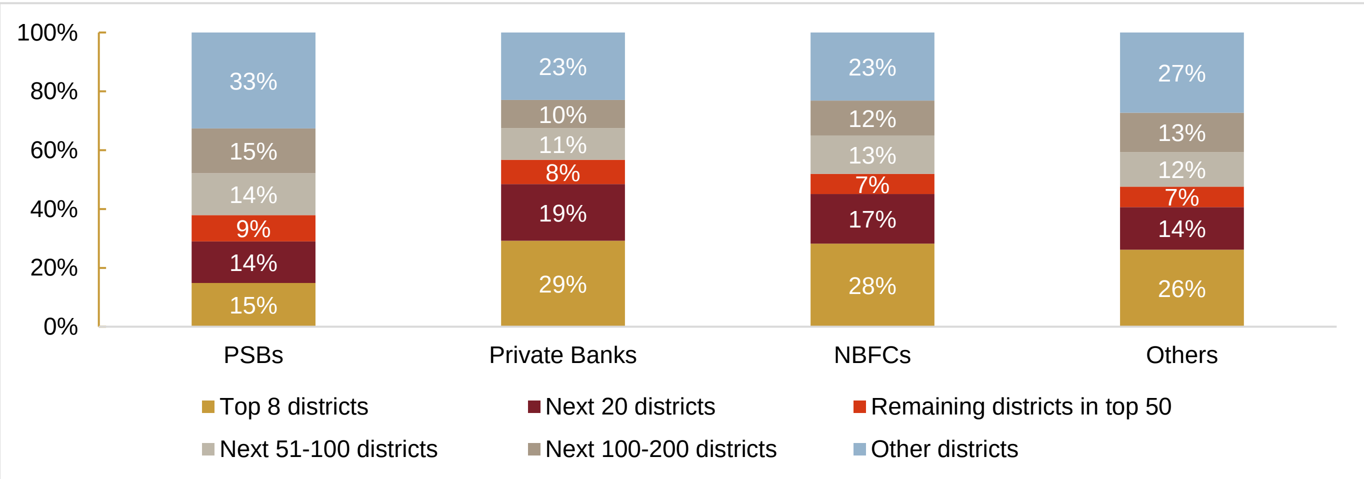
Note: Note: Above data includes business loans reported in consumer bureaus of CICs, Others includes player groups like Small Finance Banks, Foreign Banks, and Regional Rural Banks
Source: CRISIL Research

Within the small business loans (ticket size less than Rs 10 lakhs), NBFCs have 61% of loan portfolio in cities other than top 50 compared to PSBs and others which have 69% and 68% of their portfolio respectively in such cities as of June 2022. Private banks have a proportion of 59% of small business loans in cities outside the top 50. In other ticket sizes as well, similar trend is observed with PSBs being relatively better penetrated in regions outside top 50 cities compared to NBFCs and private banks being the least penetrated in such regions.

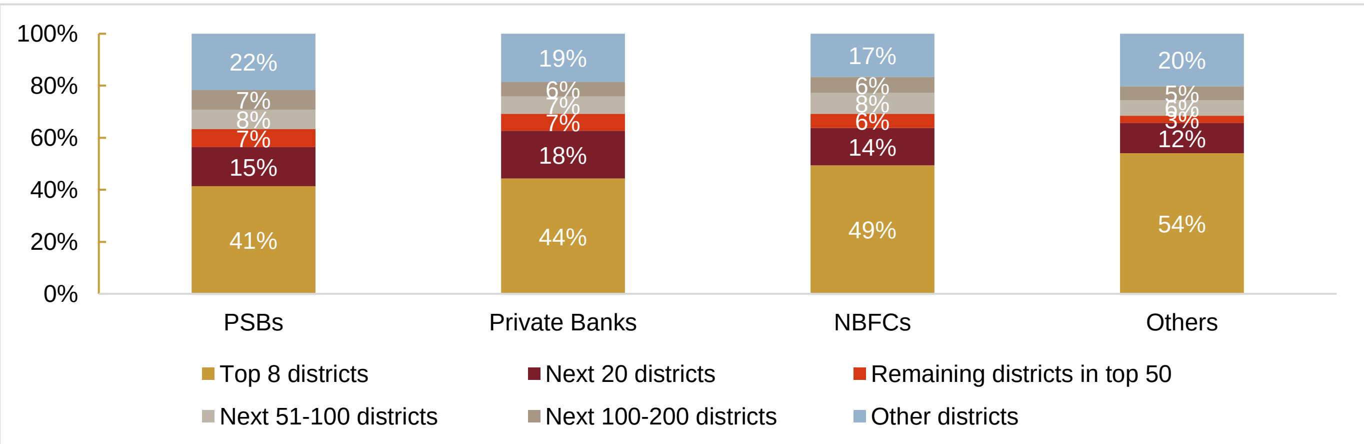
Business loans of ticket size less than Rs 10 lakhs (June 2022)



Business loans of ticket size between Rs 10-25 lakhs (June 2022)



Business loans of ticket size more than Rs 25 lakhs (June 2022)



Note: (1) Above data includes business loans given to MSMEs and reported in consumer bureaus of CICs
(2) Others includes player groups like Small Finance Banks, Foreign Banks, Regional Rural Banks
(3) Classification of districts is done based on population as per Census 2011.
(4) Mumbai Metropolitan Region (MMR), National Capital Region (NCR), Bengaluru and Kanpur have each been considered as a district.
(5) MMR includes Thane and Mumbai, NCR includes Delhi, Gurugram, Gautam Buddha Nagar, Ghaziabad and Faridabad, Bengaluru includes Bangalore Urban and Bangalore Rural, Kanpur includes Kanpur Nagar and Kanpur Dehat

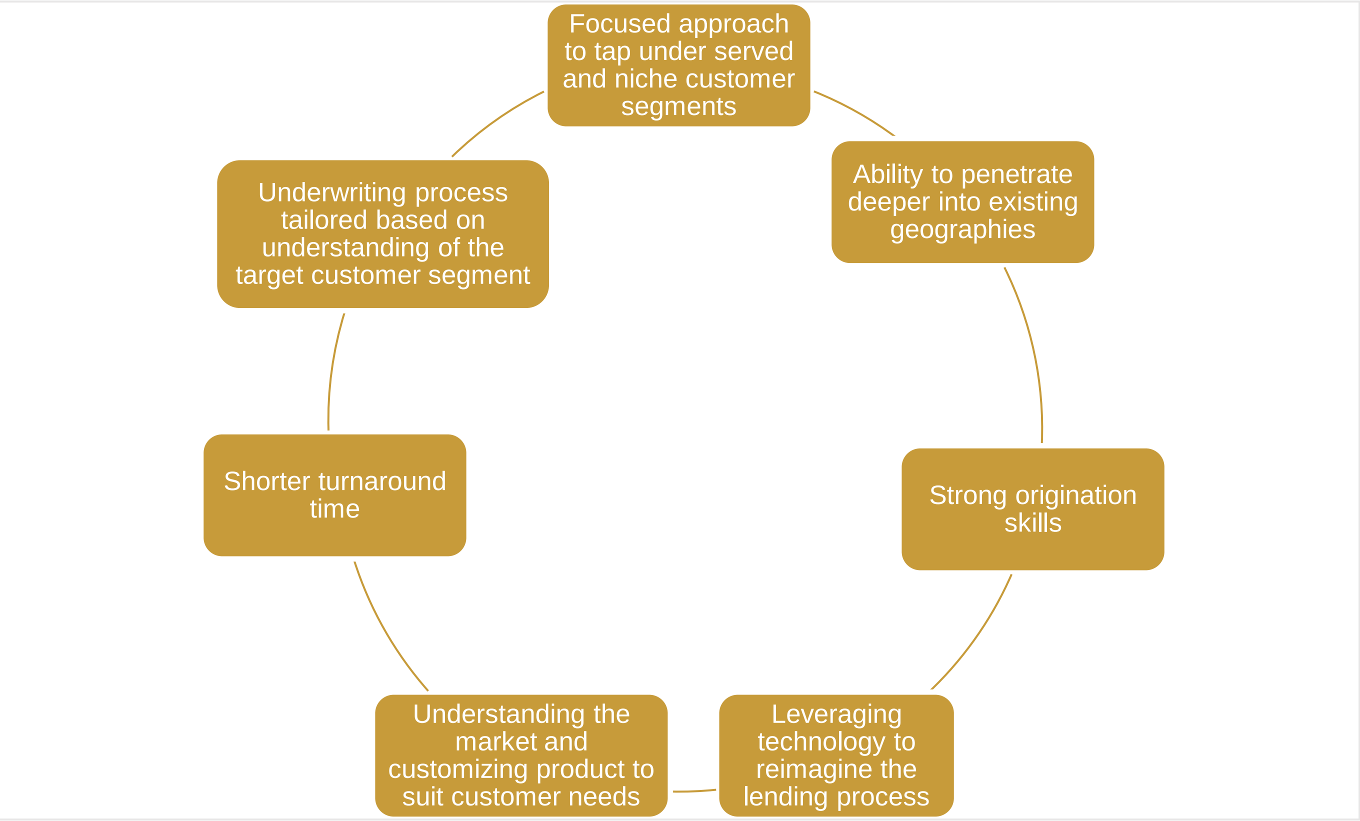
Source: CRIF Highmark, CRISIL Research

Key factors driving competitiveness of NBFCs

NBFCs in small business lending have, over the years, developed expertise in serving the underserved and niche customer segments by developing customised products (tailored to customer/business needs) and building strong credit appraisal mechanisms to serve their target segment. Moreover, their ability to penetrate deeper into geographies gives them the edge in serving these customers. Some NBFCs have tailor made underwriting processes customised for the target segment they cater to which gives them an edge in understanding and serving the customers as well as in maintaining their portfolio quality. For example, Five Star Business Finance is among the select institutions to have developed an underwriting model that evaluates the cash-flows of small business owners and self-employed individuals in the absence of traditional documentary proofs of income. NBFCs have also been leveraging technology to efficiently manage the lending process, which has also helped them reduce the turnaround time.

Going forward as well, we expect increasing adoption of technology, increasing credit penetration amongst MSMEs, ability to undertake data analytics across a larger and ever-increasing customer base, and additional data insights driving penetration in categories such as small merchants to drive growth for NBFCs. For example, with growing penetration of digital payments, just this data, when combined with financial statements data and other demographic and firm-specific data, can throw powerful insights on the creditworthiness of customers.

Factors driving growth of NBFCs in small business loans



Source: CRISIL Research

Moreover, compared to different loan products like affordable housing loans, microfinance loans, auto loans and personal loans, secured small business loans is one of the most attractive asset classes offering higher yields over a medium tenure with good collateral quality and lower default risk as the loans are secured predominantly with SORP.

	Market Size – Portfolio outstanding March 2022 (Rs trillion)	Ticket size	Yields	Typical tenure	Collateral Quality	Tendency to default
Secured property-backed small Business Loans	1.8	Small to Medium	High	Medium	Good	Low
Secured non-LAP loans	13.6	Small to Medium	High	Low	Good	Low
Microfinance loans	3.9	Small	Medium	Low	No collateral	Relatively High
Housing loan	25.4	Large	Medium	High	Very good	Low
Auto Loans	10.1	Small to Medium	Low to Medium	Low to medium	Moderate	Medium
Personal Loans	1.3	Small	High	Low	No collateral	Medium to High

Source: CRISIL Research

Small business loans market consists of highly heterogeneous players

In absolute terms, the aggregate size of lending in the small business loans segment is estimated to be around Rs 1.95 trillion as of June 2022. There are various kind of players serving this segment including Banks, NBFCs, Small Finance Banks, and Microfinance Institutions that offer loans to self-employed individuals, micro-entrepreneurs as well as MSMEs. While banks offering business loans and loans against property to MSMEs serve a very different customer segment mainly comprising registered MSMEs with documented income and certain annual turnover, other players serve customer segments who may not have appropriate income proofs on paper.

Players across the NBFC spectrum offering business loans can be classified as below:

- Larger NBFCs offering diversified loan products including business loans, both unsecured as well as secured, loans against property and products in other loan segments like commercial vehicles, personal loans, etc. These include larger players like Bajaj Finance, HDB Financial Services, and Hero Fincorp.
- NBFCs offering loans for business purpose but backed with property (residential property in almost all cases) as collateral. Examples of such NBFCs include Five Star Business Finance, Veritas Finance, and Vistaar Financial Services.
- NBFCs offering collateral-backed loans such as machinery loans for the purpose of funding capex requirements of MSMEs. These include players like Electronica Finance and MAS Financial Services.
- Fintechs, mainly offering unsecured loans to traders and the services segments, on the basis of digital underwriting models based on firm-specific demographic data, bureau scrub, bank statement analysis, GST returns and other behavioural or segment-specific data. For example, Neogrowth Credit, Lending Kart,

Capital Float, and Indifi Technologies

- Microfinance players offering loans in rural and underpenetrated areas through joint-liability groups, most of which are towards income-generation activities. Major microfinance players with an NBFC-MFI licence include Credit Access Grameen, Spandana Sphoorty, Satin Creditcare Network, Asirvad Microfinance, and Muthoot Microfinance

- Small Finance Banks with significant portfolio towards MSME loans. These include AU Small Finance Bank, Equitas Small Finance Bank (which offers micro finance as well as small business loans) and Capital Small Finance Bank.

Key Industry Parameters

	Large diversified NBFCs	NBFCs offering secured business loans backed by property as collateral	Banks (PSUs and Private)	Small Finance Banks
Average ticket size	Rs 12 lakhs to 25 lakhs	Rs 3 lakhs to 10 lakhs	Rs 20 lakhs to 37 lakhs	Rs 5 lakhs to 10 lakhs
Nature of loans	Secured: 50-60%	Secured: 100%	Secured: (80-90%)	Secured: (80-90%)
Average interest rate	18-20%	20-25%	10-15%	12-18%
Average contractual tenure	36-60 months	60-96 months	30-60 months	12-36 months
Average GNPA (as of March 2022)	4.85%	2.53%	6.30%	2.99%
NIMs (FY22)	9.6%	13.1%	2.7%	6.1%
Credit cost (FY22)	3.3%	1.3%	0.9%	2.0%
Cost to Income Ratio (FY22)	29%	28%	49%	38%
RoA (FY22)	2.9%	5.5%	0.9%	1.6%
RoE (FY22)	13.7%	12.3%	11.2%	13.2%
Documentation	Financial Statements, P&L Account, Balance Sheets, Bank Statements	Combination of traditional and non-traditional sources. Use of information available in public and private domains.	Income statements, ID Proof, KYC documents, Bank Statements	Income statements, ID Proof, KYC documents, Bank Statements.

Source: CRISIL Research

The larger NBFCs that have diversified portfolio generally operate at higher ticket sizes and offer both secured and unsecured business loans. Compared to these, NBFCs that have singular focus on small business loans or have significant proportion of small business loans in their portfolio offer customised products for the target segment and operate at ticket sizes of less than Rs 10 lakhs. These NBFCs generally have more focus on underpenetrated areas and customer profiles that may not have easy access to formal credit. This allows players to remain competitive by charging higher risk premium than other lenders operating in higher ticket sizes. Hence, these players generally have yields in the range of 20-25%. There also exists some NBFCs that offer collateral backed business loans in the ticket size band of Rs 10-15 lakhs.

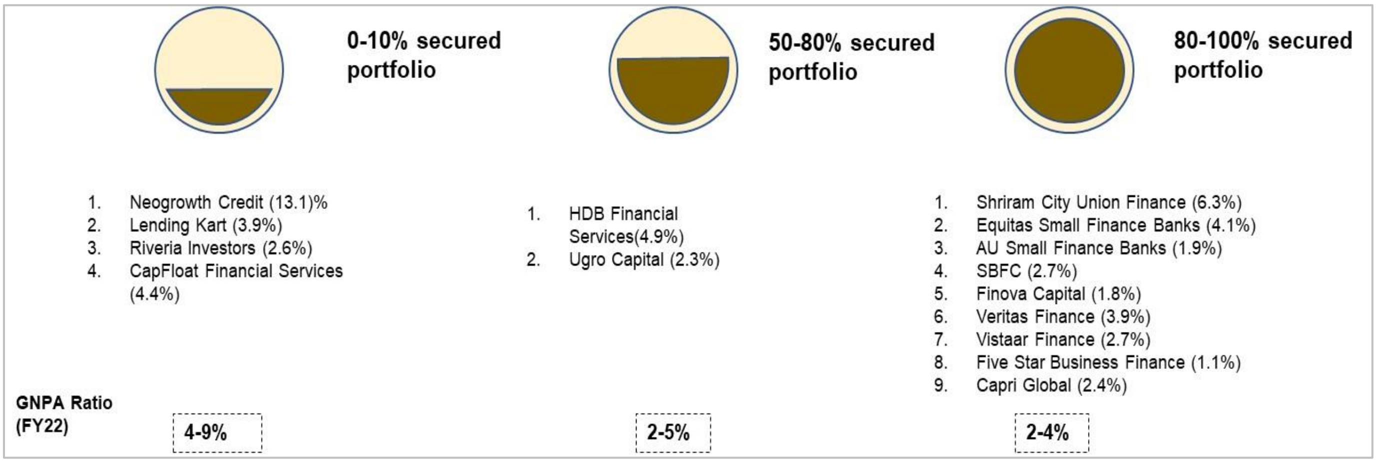
Fintech firms with NBFC licence, MFIs and SFBs are other players that operate in the small business loans landscape. Fintechs leverage data and technology in their business models and are more focussed on unsecured business loans. Hence, they also have higher yields in the range of 24-30% because of the higher risk associated with the customer profile catered and the product segment they operate in. Microfinance Institutions have a regulatory cap on total indebtedness of borrowers and household incomes; hence they operate at very low-ticket sizes in the range of Rs. 30,000 to 40,000.

Comparison of various players based on yield on advances, average ticket size and portfolio type (FY22)

	Yield less than 16%	Yield between 16% and 22%	Yield more than 22%
Average ticket size more than or equal to Rs 10 lakhs	Fedbank Financial Services Ugro Capital Capri Global Poonawala Fincorp Bajaj Finance	Shriram City Union Finance	IIFL Finance Neogrowth
Average ticket size less than Rs 10 lakhs	AU Small Finance Bank SBFC Finance	Equitas Small Finance Bank CapFloat Financial Services^	Veritas Finance Five-Star Business Finance Aye Finance Lendingkart^ Finova Capital Riviera Investors

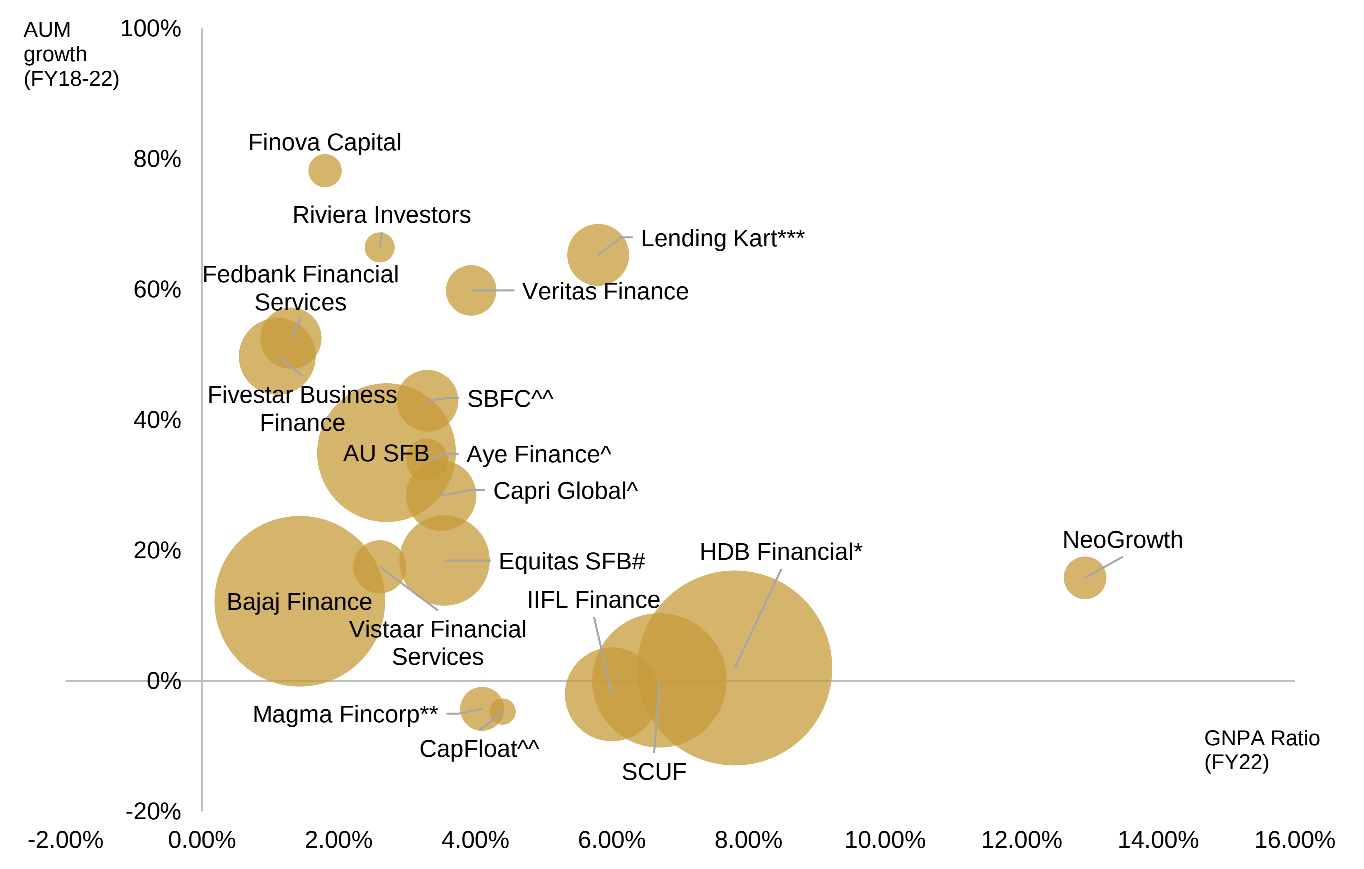
Note: ^Based on FY21 data
Source: Company Reports, CRISIL Research

Comparison of players based on secured and unsecured loans mix in small business loans



Source: Company reports, CRISIL Research

Comparison of various players based on portfolio size, portfolio growth and GNPA ratio (FY22)



Size of the bubble denotes relative size of the MSME loan portfolio as of March 2022

*Note: ^AUM as of December 2021, *GNPA as of June 2021, ^^AUM and GNPA as of September 2021, **GNPA as of September 2021, #3-year AUM CAGR, ***GNPA plus write-offs excluding one-time write-offs of restructured loans*

Source: Company Reports, CRISIL Research

Key success factors for NBFCs offering secured Small Business Loans

Strong branch network and deep understanding of the target customer segment and micro markets

Players need to have a clear and deeper understanding of their target customer segment, the micro markets they operate in and develop a strong local network. The strong network helps players to source business from niche customer category as also obtaining references from their existing customers. It is observed that successful players in the segment generally focus on a few geographies where they have a good understanding and scale up gradually to manage costs and asset quality better. This also helps fine tune their origination and credit underwriting processes over time.

Strong underwriting capabilities along with process standardisation to control operating costs

Customers in small business finance segment are generally self-employed non-professionals (carpenter, plumber, vegetable vendor, small shop keepers, etc.) and micro-entrepreneurs, people who may not have income proofs. Given the lack of income proofs, the underwriting process typically requires detailed personal discussion with the borrower as well as acquaintances and neighbours to assess the source of income and pattern of cash inflows and outflows as well as the stability and behavioural aspects of the customer. In the last few years, some lenders have also started relying on alternate data such as transactions data and digital footprint in order to underwrite customers.

Given the nature of the process, operating costs are typically very high; therefore, players who have strong credit underwriting capabilities, and who are, over a period of time, able to achieve a fair degree of standardisation in the process by building models revolving around specific customer profiles and/or geographies are more likely to be successful.

On-the-ground presence to manage collections and maintain portfolio quality

Additionally, given that players in the segment typically cater to the lower income customer segment, many of whom may not be financially literate, a strong focus on collections and monitoring risk of default at customer level is vital to manage asset quality. There is a need for players to have extensive on-the-ground presence to not only stay connected with their borrowers but also manage collections in a more efficient manner. Players are increasingly using analytical and monitoring tools enabled by technology to better predict default risk.

Collateral risk management

Properties that are used as collateral for small business loans sometimes lack proper property titles, especially in the outskirts of large cities, semi-urban and rural areas. With better availability of information and due diligence by the technical team, players can mitigate the risk.

While lenders do take appropriate measures to safeguard against this risk while sanctioning the loan, there have been instances of borrowers mortgaging the same property with multiple lenders. By registering their charge on the underlying property, lenders can protect their interest in respect of the property.

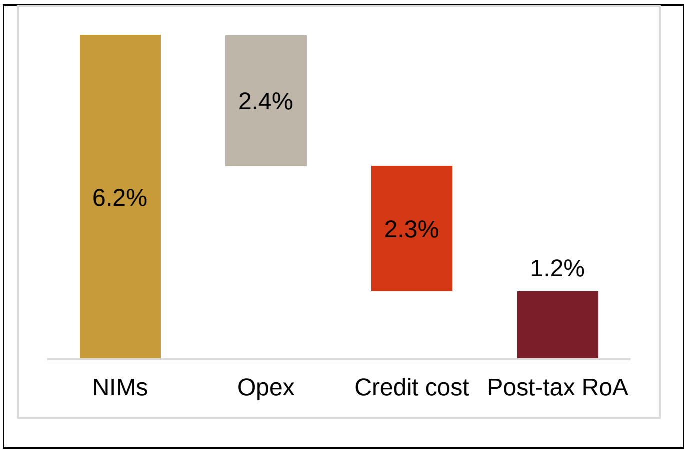
NBFC profitability to improve going forward

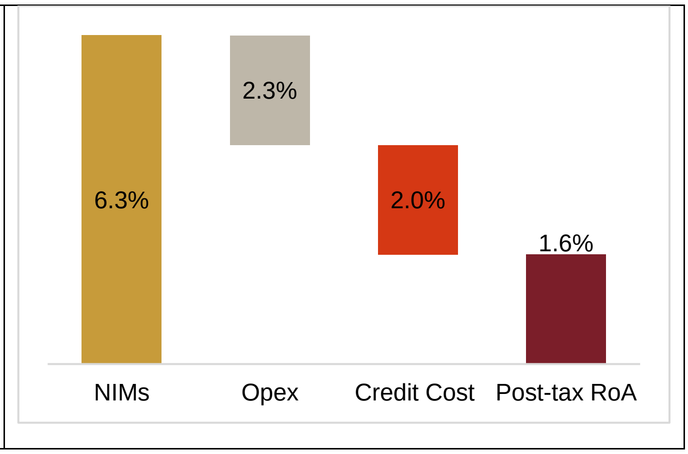
Fiscal 2021 witnessed lower interest income in the segment on account of lower yields. Lower yields, in turn, along with the higher credit cost on account of pandemic-related provisioning led to a fall in return on assets of NBFCs lending to MSMEs. In fiscal 2022, the profitability in the MSME segment has improved marginally owing to marginally lower credit costs. Operational expenses, however, remained relatively higher owing to high contribution of DSAs in originating business for NBFCs, especially in unsecured loans and increased focus of financiers on collection and digitisation of value chain.

Going forward, in fiscal 2023, borrowing costs are expected to spiral upwards, and overall profitability of MSMEs loans is still expected to be sustained in fiscal 2023, primarily on account of passing the rise in borrowing cost to MSMEs and lower credit costs due to contingency provisioning buffers created over the course of the previous two fiscals. Further, improvement in collections is expected to lead to aid profitability for the segment.

Profitability of MSME loans segment

FY21	FY22



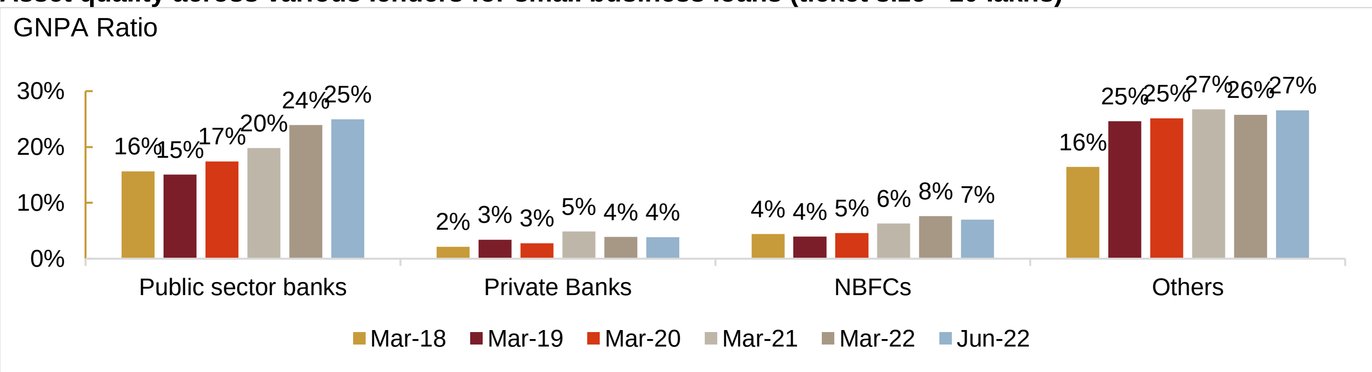


Source: CRISIL Research estimates

Asset Quality

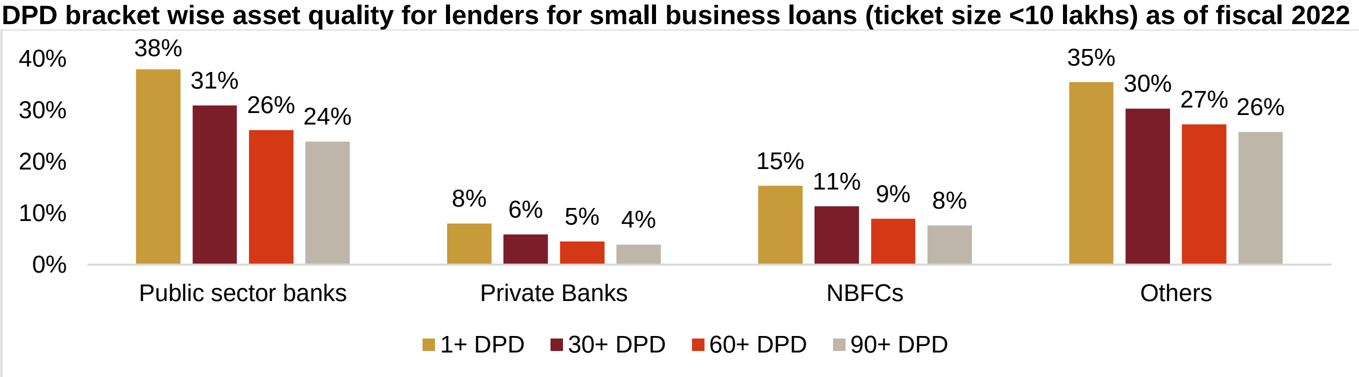
Over the past few tears, GNPAs for public sector banks and other banks has remained higher than that of NBFCs within the small business loans (ticket size less than Rs 10 lakhs) segment. Public sector banks have the highest GNPA ratio amongst the player groups, whereas NBFCs and Private banks have relatively better asset quality in this segment.

Asset quality across various lenders for small business loans (ticket size <10 lakhs)



Note: Above data includes business loans given to MSMEs upto Rs 10 lakhs ticket size and reported in consumer bureaus of CICs, Others includes player groups like Small Finance Banks, Foreign Banks, Regional Rural Banks
Source: CRIF Highmark, CRISIL Research

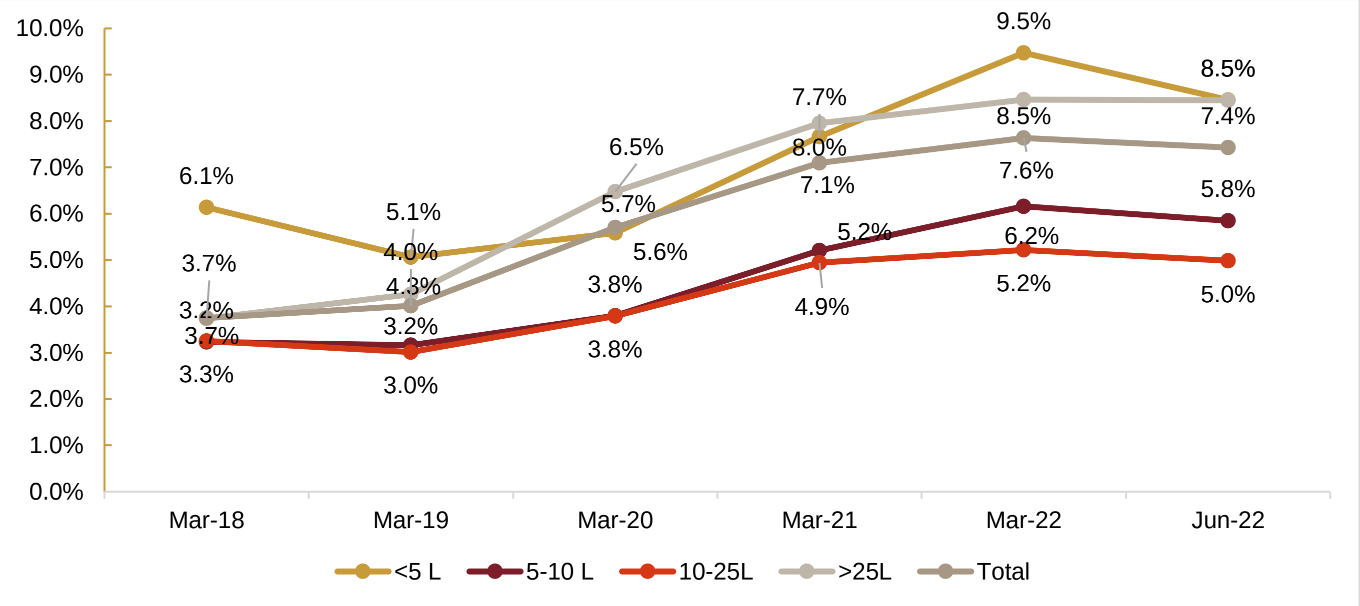
DPD bracket wise asset quality for lenders for small business loans (ticket size <10 lakhs) as of fiscal 2022



Note: Above data includes business loans given to MSMEs upto Rs 10 lakhs ticket size and reported in consumer bureaus of CICs. Others includes player groups like Small Finance Banks, Foreign Banks, Regional Rural Banks
Source: CRISIL Research

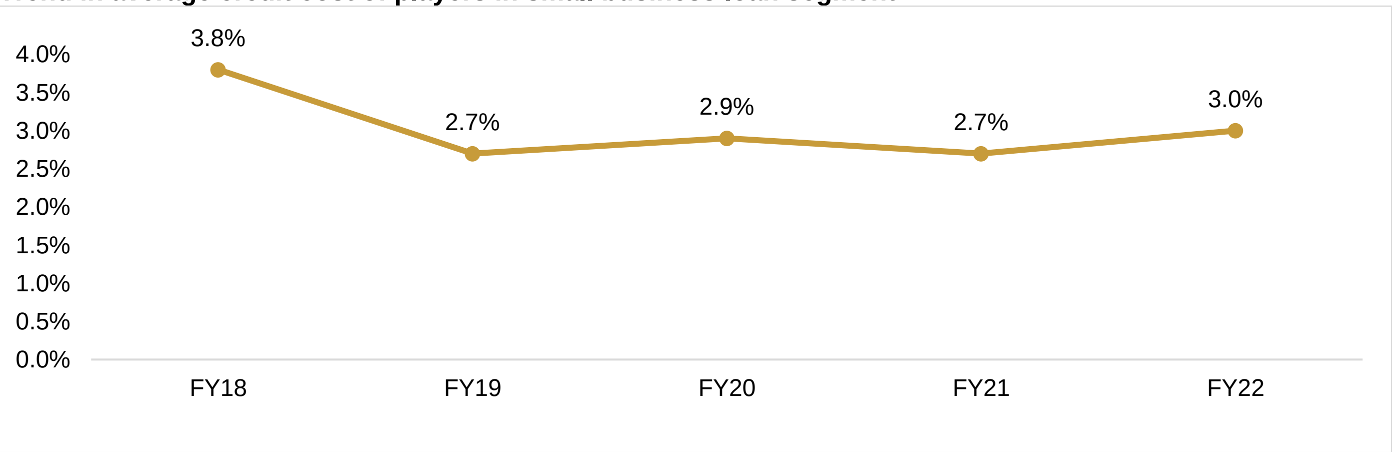
For NBFCs, as of March 2022, loan portfolio with ticket size less than Rs 5 lakhs has the worst asset quality with GNPA ratio of 9.5% compared to that of 6.2% and 5.2% for loan portfolio with ticket sizes between Rs 5 to 10 lakhs and between Rs 10 to 25 lakhs respectively. For NBFCs, as of June 2022, loan portfolio with ticket size less than Rs 5 lakhs had better asset quality than March 2022. For NBFCs portfolio with ticket size less than Rs.5 lakhs GNPA decreased from 9.5% in March 2022 to 8.5% in June 2022.

Small business loan portfolio of NBFCs exhibit better asset quality compared to overall portfolio



Note: Above data includes business loans given to MSMEs and reported in consumer bureaus of CICs
Source: CRISIL Research

Trend in average credit cost of players in small business loan segment



Note: The above data includes numbers for Five Star Business Finance, Aye Finance, Shriram City Union Finance, Veritas Finance, Vistaar Financial, Lendingkart and Digikredit Finance
Source: Company Reports, CRISIL Research

Player wise credit cost trend

Credit cost as a % of total assets	FY18	FY19	FY20	FY21	FY22
Five Star Business Finance	1.0%	0.4%	1.5%	0.7%	0.8%

Aye Finance	1.7%	2.7%	4.0%	2.7%	5.5%
Shriram City Union Finance	3.9%	2.8%	2.9%	2.6%	2.4%
Veritas Finance	1.1%	0.6%	1.0%	2.0%	2.5%
Vistaar Financial	3.2%	3.0%	3.0%	2.4%	1.4%
Lendingkart	6.4%	4.4%	6.0%	7.3%	16.1%
Digikredit Finance	NA	0.7%	5.6%	11.2%	10.7%

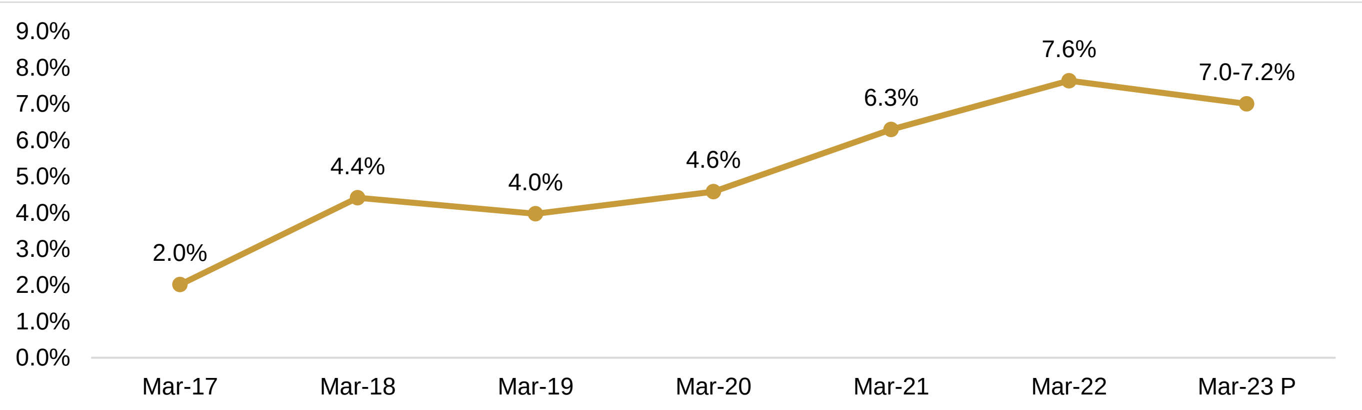
Source: Company Reports, CRISIL Research

Asset quality for NBFCs to rise in fiscal 2023

GNPAs in small business loans below Rs 10 lakhs for NBFCs has remained in the range of 4-4.5% for two years ending March 2019 after increasing post demonetisation in fiscal 2018. Asset quality deteriorated in fiscal 2020 and 2021 owing to impact on customers due to the covid-19 pandemic and GNPA ratio increased by 170 basis points to reach 6.3% compared to that as of March 2020 (4.6%). The deterioration in asset quality would have been worse, if it had not been for the support provided by the emergency credit line scheme of the government and restructuring of loans allowed by the RBI. While some portion of the portfolio has got restructured, GNPA has still increased in fiscal 2021. Second wave adversely impacted the recovery seen in the last quarter of fiscal 2021 and continued to affect collection efficiencies in fiscal 2022. GNPA for NBFCs have moderated from 7.6% in March 2022 to 7.0% in June 2022 for small business loans (ticket size <10 lakhs). CRISIL Research expects GNPA level to reach 7.0-7.2% in fiscal 2023.

The spike in NPAs could be attributed to RBI's revised NPA recognition and upgradation norms. According to RBI's Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances, for NBFCs, loan accounts classified as NPAs may be upgraded as 'standard' asset only if entire arrears of interest and principal are paid by the borrowers. NBFCs would have to comply to it by September 2022.

GNPA levels to reach to 7.0 – 7.2% in fiscal 2023 for small business loans (ticket size <10 lakhs)



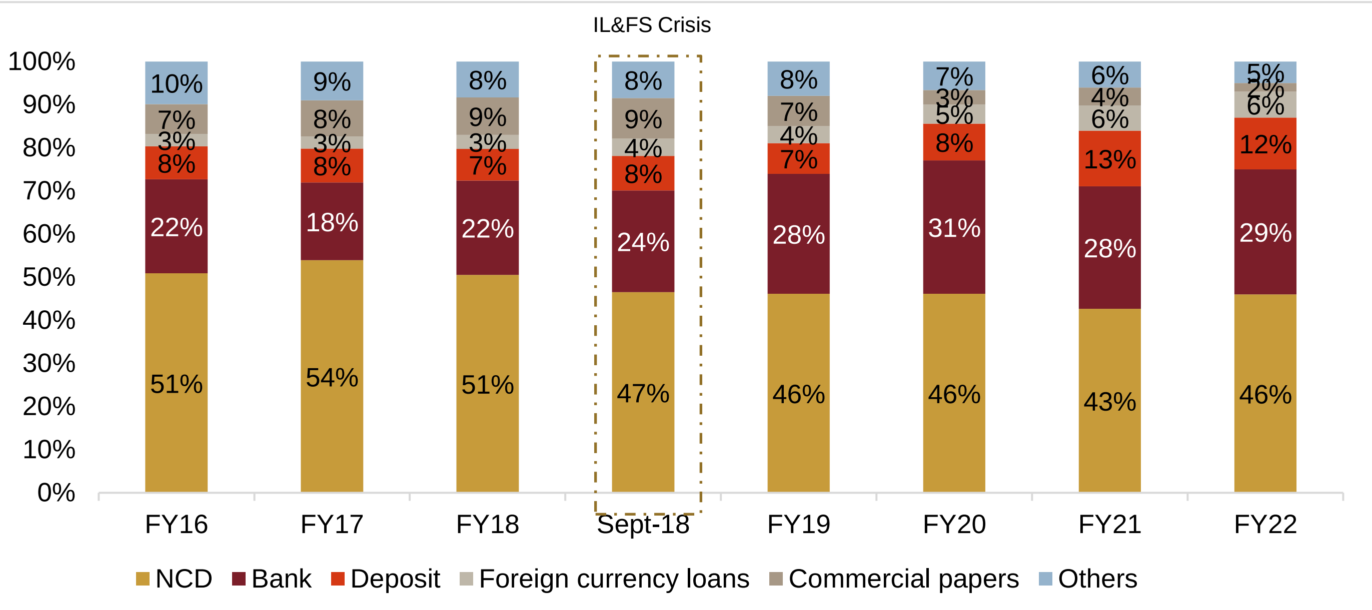
Note: Above data includes business loans given to MSMEs upto Rs 10 lakhs ticket size and reported in consumer bureaus of CICs, P-Projected
Source: CRISIL Research

Resources profile of NBFCs

NBFC's borrowing mix has been changing over the past couple of years. Capital market investors have become cautious given the challenging environment and concerns over the asset quality. Investors' risk perception has increased significantly towards players with negative asset liability management mismatch. On the other hand, NBFCs with diversified sources of borrowings, and conservative approach to asset-liability management ("ALM") have been able to overcome the severe liquidity crunch and volatile interest rates following IL&FS crisis. Therefore, access to the capital markets has been restricted to limited players, with others relying more on bank borrowings and borrowings from larger NBFCs and overseas debt investors to meet their requirement. This has resulted in reduction in share of Commercial Papers ("CPs") and non-convertible debentures ("NCDs") and a corresponding increase in banks borrowings during fiscal 2019 to fiscal 2021.

In fiscal 2022, NBFCs' borrowings from banks continued to grow at y-o-y growth rate of 10%. Total bank borrowings increased from Rs. 5 trillion at end of March 2018 to Rs. 10.5 trillion at end of March 2022 which brought their share from 22% to 29% during the same period. Borrowings through non-convertible debentures increased to 46% of the resources mix of NBFCs as of March 2022, up from 43% at end of March 2021. During the second wave of COVID-19 pandemic, NBFCs reduced their borrowings from commercial paper due to adequate liquidity on their books. The share of CPs in the resources mix of NBFCs also decreased from 4% at end of March 2021 to 2% at end of March 2022. Going forward, CRISIL believes that funding access would gradually improve for NBFCs who are able to demonstrate strong performance. However, reliance on bank funding and funding from other NBFCs and small finance banks is expected to remain high.

Banks expected to remain primary lenders for the NBFCs



Note: Based on sample set of NBFCs accounting for more than 80% of overall borrowings of NBFCs as of March 2022; For FY22, NCD includes Debt Securities and NCDs, Bank includes Banks and National Housing Bank, and Others include Related Parties, Foreign Institutions, External Commercial Borrowings and other sources.
Source: Company reports, CRISIL Research

Peer benchmarking

Five Star Business Finance is focused on providing secured business loans to micro entrepreneurs and self-employed individuals who are largely ignored by the formal financial system. In this section, we have compared Five Star Business Finance Limited (Five Star Business) with other NBFCs and HFCs as also small finance banks (SFBs) focused on serving the target segment served by Five Star Business i.e., self-employed entrepreneurs running small businesses and operating in a similar ticket size band. The peer comparison has been done based on the latest available data for fiscal 2022.

In our assessment, we have considered NBFCs present in secured small business loans, namely Shriram City Union Finance (SCUF), Vistaar Financial Services Private Limited (Vistaar Finance), and Veritas Finance Private Limited (Veritas Finance). AU Small Finance Bank that provides secured small business loans has also been included in our assessment. In addition, mortgage loan providers targeting a similar customer profile as Five-Star Business – Aavas Financiers Ltd, Aptus Value Housing Finance India Limited (Aptus Value Housing) and Home First Finance Company India Limited (Home First Finance) have been included in our peer list. Besides, we have considered players providing unsecured small business loan such as Lendingkart Technologies Private Limited (Lendingkart), Digikredit Finance Private Limited (Digikredit Finance) and Aye Finance Private Limited (Aye Finance). For purposes of the discussion below, lenders engaged in extending MSME business loans include Shriram City Union Finance, Five Star Business Finance, Lendingkart Finance, Vistaar Finance, Veritas Finance, Aye Finance and Digikredit Finance.

Five Star Business is one of the fastest growing NBFC among the compared peers

Five Star Business recorded the fourth fastest AUM growth of 50% CAGR over fiscal 2018-22 among the compared peers. Digikredit Finance has the highest AUM growth of CAGR 128% over fiscal 2018-22 followed by Lendingkart at 63% and Veritas Finance at 60% in the same time frame, albeit a lower base.

Five Star Business recorded the fourth fastest disbursement growth of 26% CAGR over fiscal 2018-22 among the compared peers. Other players such as Veritas Finance and Home First Finance witnessed a growth of 39% and 28% respectively over fiscal 2018-22.

Trend in Assets Under Management for players

AUM (Rs billion)	FY18	FY19	FY20	FY21	FY22	CAGR (FY18-22)
AU Small Finance Bank^	58	86	113	143	165	30%
Shriram City Union Finance^	155	177	166	151	147	-1%
Aavas Financiers	41	59	78	95	113	29%
Five Star Business	**10**	**21**	**39**	**44**	**51**	**50%**
Home First Finance	14	24	36	41	54	41%
Aptus Value Housing	14	22	32	41	52	38%
Lendingkart	5	14	24	25	33	63%
Vistaar Finance	13	14	19	21	24	17%
Veritas Finance	3	7	13	16	22	60%
Aye Finance	5	10	18	16	15*	34%
Digikredit Finance	0	2	4	5	5*	128%

Note: (^) Data pertains to small business loans and MSME portfolio, (*) Data as of December 2021, NA - Not available
Source: Company reports, Rating reports, CRISIL Research

Trend in Disbursements for players

Disbursement (Rs billion)	FY18	FY19	FY20	FY21	FY22	CAGR (FY18-22)
AU Small Finance Bank^	27	37	49	47	48	15%
Shriram City Union Finance^	105	104	73	32	70	-10%
Aavas Financiers	21	27	29	27	36	15%
Five Star Business	**7**	**15**	**24**	**12**	**18**	**26%**
Home First Finance	7	16	16	11	20	28%
Aptus Value Housing	8	12	13	13	16	22%
Lending kart	NA	17	24	11	27	18%**
Vistaar Finance	7	8	9	6	NA	-4%*
Veritas Finance	3	6	8	6	12	39%
Aye Finance	5	10	16	7	NA	50%*
Digikredit Finance	NA	NA	NA	NA	NA	NM

Note: (^) Data pertains to small business loans and MSME portfolio, (*) CAGR for FY17-21, (**) CAGR for FY19-22
NA - Not available; NM: Not meaningful.
Source: Company reports, Rating reports, CRISIL Research

Percentage of secured portfolio for players (FY22)

Rs billion	% share of Secured Portfolio	AUM		Disbursement	
		FY21	FY22	FY21	FY22
AU Small Finance Bank^	100%	143	165	47	48
Shriram City Union Finance^	82%	151	147	32	70
Aavas Financiers	100%	95	113	27	36
Five Star Business	**100%**	**44**	**51**	**12**	**18**
Home First Finance	100%	41	54	11	20
Aptus Value Housing	100%	41	52	13	16
Lending kart	0%	25	33	11	27
Vistaar Finance	100%	21	24	6	NA
Veritas Finance	100%	16	22	6	12
Aye Finance	0%	16	15*	7	NA
Digikredit Finance	11%	5	5*	NA	NA

Notes: (^) AUM and disbursement data for MSME/Small business loan segment, (*) Data as of December 2021, NA - Not available
Source: Company reports, Rating reports, CRISIL Research

Operational efficiency

Five Star Business' AUM per branch has increased to Rs 169 million in fiscal 2022 from Rs 154 million in fiscal 2020; Five Star Business has one of the largest branch networks amongst non-banks

Five Star Business has the third highest branch growth rate over fiscals 2018-22 at 23%. With 300 branches as of March 2022, Five Star Business has one of the largest branch networks amongst the non-bank universe, next only to Shriram City Union Finance, Aye Finance and Aavas Financiers amongst the peer set. Aye Finance had the highest branch growth followed by Veritas Finance over the same time period. Five Star Business had the second highest employee growth at 45% over fiscals 2018-22.

Despite increasing the number of branches, its AUM per branch has increased by 21% CAGR to Rs 169 million over fiscals 2018-22. While its AUM per branch is lower as compared to lenders focused in mortgage loans, they are higher as compared to other lenders focused on MSME financing who have a branch focused business model (by around 1.5-2.0 times). This is also reflected in its cost to income ratio which is much lower than other MSME focused lenders. Fintech lenders in the unsecured MSME loans space operate with minimal branch infrastructure on the ground and hence do not have relatable branch productivity matrices, but their cost to income ratios are higher compared to Five Star Business.

In terms of disbursement per branch, Five Star Business has the second highest disbursement per branch among MSME focused lenders next to Shriram City Union Finance. Five Star Business has the second highest AUM per employee in fiscal 2022 at Rs 9 million next only to Vistaar Finance at Rs 12 million in fiscal 2022 among MSME focused lenders. Five Star Business' average disbursement per employee at Rs 4 million over fiscals 2020-22 is comparable to other MSME focused lenders like Veritas Finance (Rs 4 million) and Veritas Finance (Rs 4 million) in the same time period.

The branch productivity has also to be viewed in the context of the segment and ticket sizes in which a company operates. Five Star Business' average ticket sizes, at around Rs. 2,30,000 in fiscal 2022, is the lowest compared to other players considered in the peer set.

Five Star Business has the third lowest cost to income ratio at end of fiscal 2022

Five Star Business has the third lowest cost to income ratio in fiscal 2022 among the compared peers. Aptus Value Housing has the lowest cost to income ratio at 18.6% in fiscal 2022. It is followed by Aavas Financiers (30.9%) and Five Star Business (32.0%) in fiscal 2022.

Trend in number of branches for players

Branches	FY18	FY19	FY20	FY21	FY22	CAGR (FY18-22)
AU Small Finance Bank^	377	572	647	744	919	16%
Shriram City Union Finance	969	969	947	926	986	0%
Aavas Financiers	165	210	250	280	314	17%
Five Star Business	**130**	**173**	**252**	**262**	**300**	**23%**
Home First Finance	45	60	68	72	80	16%

Aptus Value Housing	115	142	175	190	208	16%
Lending kart	NA	NA	NA	NA	NA	NM
Vistaar Finance	225	220	216	191	192	-4%
Veritas Finance	72	147	202	204	229	34%
Aye Finance	72	104	173	211	312	44%
Digikredit Finance	NA	15	25	18	18	6%**

Note:(**) CAGR calculated from FY19-22, (^) Touchpoints

NA - Not available; NM – Not meaningful

Source: Company reports, Rating reports, CRISIL Research

Trend in number of employees for players

Employees	FY18	FY19	FY20	FY21	FY22	CAGR (FY18-22)
AU Small Finance Bank	11,151	12,623	17,112	22,484	27,817	26%
Shriram City Union Finance	28,665	27,267	28,699	24,963	27,997	-1%
Aavas Financiers	1,862	3,190	4,581	5,679	5,222	29%
Five Star Business	**1,290**	**1,971**	**3,734**	**3,938**	**5,675**	**45%**
Home First Finance	382	675	696	687	851	22%
Aptus Value Housing	1,000	1,325	1,702	1,913	2,271	23%
Lending kart	NA	350	NA	NA	NA	NM
Vistaar Finance	2,107	2,188	1,847	1,660	1,966*	-2%
Veritas Finance	719	1,422	1,850	2,333	2,727	40%
Aye Finance	1,085	1,887	3,162	3865	NA	53%^
Digikredit Finance	NA	NA	850	NA	NA	NM

Note: (*) Employees as of December 2021, (^) CAGR for FY18-21, NA - Not available; NM – Not meaningful
Source: Company reports, Rating reports, CRISIL Research

Trend in AUM per branch and Disbursement per branch for players

	AUM per branch (Rs million)				Disbursement per branch (Rs million)			
	FY20	FY21	FY22	Average (FY20-22)	FY20	FY21	FY22	Average (FY20-22)
AU Small Finance Bank^	174	193	180	182	75	63	52	63
Shriram City Union Finance^	176	163	149	163	77	35	71	61
Aavas Financiers	312	338	361	337	117	95	115	109
Five Star Business	**154**	**170**	**169**	**164**	**96**	**48**	**59**	**67**
Home First Finance	532	575	673	593	238	152	254	215
Aptus Value Housing	182	214	249	215	73	68	79	73
Lending kart	NA	NA	NA	NM	NA	NA	NA	NM
Vistaar Finance	87	108	126	107	42	30	NA	36*
Veritas Finance	64	77	96	79	42	30	52	41
Aye Finance	103	74	48**	75	94	32	NA	NM
Digikredit Finance	153	253	272	226	NA	NA	NA	NM

Note: (^) Data pertains to small business loans and MSME portfolio, (*) Average of FY20, FY21, (**) Data as of December 2021

NA - Not available; NM - Not meaningful
Source: Company reports, CRISIL Research

Trend in AUM per employee and Disbursement per employee for players

	AUM per employee (Rs million)				Disbursement per employee (Rs million)			
	FY20	FY21	FY22	Average (FY20-22)	FY20	FY21	FY22	Average (FY20-22)
AU Small Finance Bank^	7	6	6	6	3	2	2	2
Shriram City Union Finance^	6	6	5	6	3	1	2	2
Aavas Financiers	17	17	22	18	6	5	7	6
Five Star Business	**10**	**11**	**9**	**10**	**6**	**3**	**3**	**4**
Home First Finance	52	60	63	58	23	16	24	21
Aptus Value Housing	19	21	23	21	8	7	7	7
Lending kart	NA	NA	NA	NM	NA	NA	NA	NM
Vistaar Finance	10	12	12**	12	5	3	NA	4*
Veritas Finance	7	7	8	7	5	3	4	4
Aye Finance	6	4	NA	5*	5	2	NA	3*
Digikredit Finance	NA	NA	NA	NM	NA	NA	NA	NM

Note: (^) Data pertains to small business loans and MSME portfolio, (*) Average of FY20, FY21, (**) Employees as of December 2021
NA - Not available; NM - Not meaningful
Source: Company reports, CRISIL Research

Trend in Cost to Income Ratio and Opex for players

	Cost to income ratio				Opex (%of average assets)			
	FY20	FY21	FY22	Average (FY20-22)	FY20	FY21	FY22	Average (FY20-22)
AU Small Finance Bank	54.2%	43.8%	57.1%	51.7%	3.8%	3.5%	4.0%	3.8%
Shriram City Union Finance	40.3%	37.8%	41.2%	39.8%	5.0%	4.2%	4.4%	4.5%
Aavas Financiers	42.0%	39.6%	30.9%	37.5%	3.5%	3.1%	2.6%	3.0%
Five Star Business	**30.1%**	**29.5%**	**32.0%**	**30.6%**	**5.1%**	**4.2%**	**5.0%**	**4.8%**
Home First Finance	45.1%	38.8%	33.9%	39.3%	3.4%	2.6%	2.7%	2.9%
Aptus Value Housing	26.1%	22.3%	18.6%	22.3%	2.4%	2.4%	2.3%	2.4%
Lending kart	43.8%	33.2%	42.5%	39.8%	5.3%	4.2%	6.6%	5.4%
Vistaar Finance	53.2%	43.8%	50.8%	49.3%	7.5%	5.2%	5.5%	6.1%
Veritas Finance	65.2%	49.0%	48.9%	54.4%	7.6%	5.8%	6.4%	6.6%
Aye Finance	61.2%	68.4%	80.4%	70.0%	8.3%	8.7%	10.3%	9.1%
Digikredit Finance	183.5%	143.6%	129.4%	152.2%	28.7%	20.8%	24.5%	24.7%

Source: Company reports, CRISIL Research

Product mix of players (FY22)

Players	Business loans and	Vehicle/ Auto Loans	Home loans	LAP	Gold loans	Large and mid-	Others

	MSME Finance					corporate loans	
AU Small Finance Bank	35%	36%	6%	-	-	17%	6%
Shriram City Union Finance	44%	29%	-	2%	12%	-	12%
Aavas Financiers	-	-	72%	-	-	-	28%
Five Star Business	**62%**	**-**	**-**	**-**	**-**	**-**	**38%**
Home First Finance	-	-	91%	-	-	-	9%
Aptus Value Housing	20%	-	56%	24%	-	-	-
Lending kart	100%	-	-	-	-	-	-
Vistaar Finance	99%	-	-	-	-	-	1%
Veritas Finance	94%*	-	-	-	-	-	6%
Aye Finance	100%	-	-	-	-	-	-
Digikredit Finance	89%	-	-	11%	-	-	-

*Note: *Includes construction finance loans, Others for Five star Business are for asset creation and other end uses of the customers*
Source: Company reports, CRISIL Research

Five Star Business average ticket size is one of the lowest among the compared peers

Trend of ticket size and LTV of players

FY22	Average ticket size (Rs)	Average LTV	Share of Self-employed	Share of New to credit	No. of states and UTs present in
AU Small Finance Bank^	8,40,000	NA	61%**	NA	20
Shriram City Union Finance	12,50,000	NA	NA	NA	24
Aavas Financiers	8,64,000	54%	60%	NA	13
Five Star Business	**2,30,000**	**~45%**	**100%**	**NA**	**9**
Home First Finance	10,50,000	57%	28%	40%	13
Aptus Value Housing	6,20,000^	35%	72%	40%	5
Lending kart	7,00,000	NM	100%	NA	34
Vistaar Finance	3,50,000*	50%	100%	NA	12
Veritas Finance	3,50,000	<50%	99.9%	NA	9
Aye Finance	1,00,000	NA	100%	NA	20
Digikredit Finance	NA	NA	100%	NA	4

Note: (^) For Business Loans; (**) For Housing portfolio, (*) Data as of fiscal 2021, NA - Not available; NM: Not meaningful
Source: Company reports, CRISIL Research

Most players tend to have geographically concentrated portfolios

It is observed that all players in the considered peer set have a significant portion of their portfolio (between 33-53%) emanating from the largest state in their respective portfolios. This is because strong understanding of the regional dynamics, local market connects and understanding of customer psyche and behaviour are extremely critical to succeed in the customer segment these players cater to. Therefore, players prefer to start slow and mine deeper in various geographies only once they have a reasonable degree of comfort with the regional dynamics and observed data on customer behaviour.

Five Star Business is a South-based player with the top 4 southern states i.e., Tamil Nadu, Andhra Pradesh, Telangana and Karnataka, cumulatively accounting for 93% of AUM at end of March 2022. The company has, however, started spreading its portfolio to other states including Maharashtra, Madhya Pradesh, Chandigarh and Uttar Pradesh.

Statewise distribution of AUM at end of fiscal 2022

Players	Share of top state	Name of top 5 states
AU Small Finance Bank	30%	Rajasthan (30%), Maharashtra (22%), Delhi NCR (12%), Punjab (9%) and Haryana (7%)
Shriram City Union Finance	NA	NA
Aavas Financiers	39%	Rajasthan (39%)
Five Star Business	**38%**	**Tamil Nadu (38%), Andhra Pradesh (29%), Telangana (19%), Karnataka (7%) and Others (6%)**
Home First Finance	36%	Gujarat (36%), Maharashtra (16%), Tamil Nadu (12%), Karnataka (9%)
Aptus Value Housing	48%	Tamil Nadu (48%), Andhra Pradesh (31%), Karnataka (12%) and Telangana (9%)
Lending kart	15%^	NA
Vistaar Finance	37%	Tamil Nadu (37%), Karnataka (23%), Andhra Pradesh (11%), Maharashtra (7%)
Veritas Finance	39%	Tamil Nadu (39%)
Aye Finance	17%	Uttar Pradesh (17%), Rajasthan (14%), Haryana (9%), Madhya Pradesh (9%)
Digikredit Finance	NA	NA

Note: Figures in the bracket after each state relate to the share of the state in the AUM of the respective company
^Less than 15%; NA – Not available
Source: Company reports, CRISIL Research

Profitability

Five Star Business has the highest Net Interest Margin (NIMs) in fiscal 2022 amongst peer set

Among the compared peers, Five Star Business has the highest NIMs of 14.9% in fiscal 2022, which can be attributed to the strong yields it has been able to charge because of specific focus on the target segment. Five Star Business has the fourth highest yield on advances at 24.7% at end of fiscal 2022. Amongst the compared peer set, Digikredit Finance has the highest yield on advances in fiscal 2022 at 31.7%, followed by Lendingkart at 29.6% in fiscal 2022.

The cost of funds for Five Star Business has come down which has significantly come down from 13.1% at end of fiscal 2020 to 10.0% at end of fiscal 2022.

Five Star Business has the second highest growth in Profit after Tax (PAT) in fiscal 2022 amongst peer set

Among the compared peers, Five Star Business has the second highest growth in PAT at 71% over fiscals 2018-22. Veritas Finance has shown the highest growth rate in PAT at 88% over fiscal 2018-22.

Five Star Business has the second highest net profit margin in fiscal 2022 among peer set

Among the compared peers, Aptus Value Housing has the highest net profit margin at 44% in fiscal 2022. It is followed by Five Star Business (36%) and Home First Finance (31%) at end of fiscal 2022.

Five Star Business has the highest Return on assets (RoA) in fiscal 2022 among peer set

At end of fiscal 2022, Five Star Business has the highest Return on assets at 7.5%. It is followed by Aptus Value Housing and Home First Finance with RoA at 7.3% and 3.9%, respectively.

In terms of Return on Equity (RoE), AU small finance bank has the highest Return on Equity of 16.4% in fiscal 2022. It is followed by Aptus Value Housing (15.1%) and Five Star Business (15.0%) in fiscal 2022. Over fiscal 2020-22, the average RoE for Five Star Business stood at 15.9%, only after AU SFB with a RoE of 18.8% over the same period.

Trend of Yield on advances and NIMs of players

	Yield on advances (%)				NIMs (%)			
	FY20	FY21	FY22	Avg. (FY20-22)	FY20	FY21	FY22	Avg. (FY20-22)
AU Small Finance Bank	13.7%	12.8%	12.1%	12.9%	5.1%	5.0%	5.4%	5.2%
Shriram City Union Finance	20.9%	20.1%	20.5%	20.5%	11.8%	10.5%	9.9%	10.7%
Aavas Financiers	13.5%	13.1%	12.8%	13.2%	6.5%	6.2%	6.5%	6.4%
Five Star Business	**24.2%**	**24.3%**	**24.7%**	**24.4%**	**15.8%**	**13.6%**	**14.9%**	**14.8%**
Home First Finance	13.3%	12.8%	12.5%	12.9%	5.4%	5.3%	6.2%	5.6%
Aptus Value Housing	17.6%	17.2%	17.2%	17.3%	7.3%	10.2%	11.4%	9.6%
Lending kart	24.7%	23.7%	29.6%	26.0%	13.3%	12.2%	14.5%	13.4%
Vistaar Finance	20.7%	19.2%	18.6%	19.5%	12.2%	10.0%	9.5%	10.6%
Veritas Finance	24.9%	23.4%	22.4%	23.6%	10.5%	11.3%	12.3%	11.4%
Aye Finance	28.5%	29.0%	25.3%	27.6%	15.2%	12.0%	11.6%	12.9%
Digikredit Finance	28.6%*	24.6%*	31.7%*	28.3%	7.1%	7.8%	11.5%	8.8%

*Note: *Total interest income is considered for calculation*
Source: Company reports, CRISIL Research

Trend of cost of funds of players

Cost of funds (%)	FY20	FY21	FY22	Average (FY20-22)
AU Small Finance Bank	7.4%	6.5%	5.3%	6.4%

Shriram City Union Finance	9.4%	8.8%	9.0%	9.0%
Aavas Financiers	7.9%	7.8%	6.7%	7.5%
Five Star Business	**13.1%**	**11.2%**	**10.0%**	**11.4%**
Home First Finance	8.8%	7.8%	6.6%	7.7%
Aptus Value Housing	10.2%	9.1%	8.0%	9.1%
Lending kart	13.4%	12.6%	13.9%	13.3%
Vistaar Finance	10.8%	10.2%	9.2%	10.1%
Veritas Finance	13.2%	10.7%	10.5%	11.5%
Aye Finance	12.8%	17.0%	11.2%	13.6%
Digikredit Finance	15.0%	12.5%	14.2%	13.9%

Source: Company reports, CRISIL Research

Trend of Profit After Tax(PAT) of players

PAT (Rs million)	FY18	FY19	FY20	FY21	FY22	CAGR (FY18-22)
AU Small Finance Bank	2,920	3,818	6,748	11,707	11,298	40%
Shriram City Union Finance	7,109	9,889	10,005	10,109	10,862	11%
Aavas Financiers	931	1,759	2,491	2,895	3,568	40%
Five Star Business	**534**	**1,567**	**2,620**	**3,590**	**4,535**	**71%**
Home First Finance	252	422	796	1,001	1,861	65%
Aptus Value Housing	667	1,117	2,110	2,669	3,701	53%
Lending kart	(231)	277	297	183	(1,414)	57%
Vistaar Finance	326	337	450	648	742	23%
Veritas Finance	61	171	333	620	754	88%
Aye Finance	23	251	325	169	(457)	NM
Digikredit Finance	(48)	(149)	(392)	(491)	(443)	NM

Note: NA – Not Available, NM – Not meaningful, Source: Company reports, CRISIL Research

Trend of Net Profit Margin of players

Net profit margin	FY20	FY21	FY22	Average (FY20-22)
AU Small Finance Bank	14%	18%	16%	16%
Shriram City Union Finance	17%	18%	17%	17%
Aavas Financiers	28%	26%	27%	27%
Five Star Business	**33%**	**34%**	**36%**	**35%**
Home First Finance	19%	20%	31%	24%
Aptus Value Housing	40%	39%	44%	41%
Lending kart	6%	4%	-22%	-4%
Vistaar Finance	12%	16%	17%	15%
Veritas Finance	12%	17%	17%	15%
Aye Finance	8%	3%	-10%	0%
Digikredit Finance	-83%	-86%	-63%	-77%

Source: Company reports, CRISIL Research

Trend of Return of Assets and Return of Equity of players

	RoA (%)				RoE (%)			
	FY20	FY21	FY22	Average (FY20-22)	FY20	FY21	FY22	Average (FY20-22)
AU Small Finance Bank	1.8%	2.5%	1.9%	2.1%	17.9%	22.0%	16.4%	18.8%
Shriram City Union Finance	3.3%	3.1%	2.9%	3.1%	14.7%	13.2%	12.7%	13.5%
Aavas Financiers	3.8%	3.5%	3.6%	3.6%	12.7%	12.9%	13.7%	13.1%
Five Star Business	**7.8%**	**7.1%**	**7.5%**	**7.5%**	**15.8%**	**16.8%**	**15.0%**	**15.9%**
Home First Finance	2.7%	2.5%	3.9%	3.0%	10.9%	8.6%	12.6%	10.7%
Aptus Value Housing	5.1%	6.5%	7.3%	6.3%	17.5%	14.5%	15.1%	15.7%
Lending kart	1.5%	0.7%	-5.5%	-1.2%	4.9%	2.5%	-21.1%	-4.6%
Vistaar Finance	2.5%	3.0%	2.9%	2.8%	7.3%	9.6%	10.0%	9.0%
Veritas Finance	2.3%	3.1%	3.1%	2.8%	5.3%	7.3%	6.6%	6.4%
Aye Finance	2.0%	0.8%	-2.1%	0.2%	6.5%	2.7%	-6.3%	1.0%
Digikredit Finance	-19.2%	-18.3%	-17.6%	-18.4%	-30.8%	-47.6%	-64.5%	-47.7%

*Note: * In calculation of RoA and RoE, PAT Includes profit on sale of Aavas stake for AU SFB, Return on assets (RoA) computed above is defined as profit after tax for the year divided by the average of the opening and closing total assets for the year as reported in the annual reports / public disclosures for these companies. The information contained in this table may deviate from the methodology that individual companies (including Five Star Business) may use to calculate Return on assets and as such, investors are advised to read that data together with the corresponding definition used for computing the Return on assets therein, Source: Company reports, CRISIL Research*

Five Star Business has the second best asset quality among the compared peers; best asset quality amongst MSME focused lenders

Among the compared peers, Five Star Business has the second best asset quality and best asset quality amongst compared peers and amongst MSME focused lenders respectively. Gross NPA ratio of Five Star Business stood at 1.05% in FY2022 with all the other MSME focused players reporting Gross NPA of more than 2%.

Trend of Gross NPA of players

GNPA	FY20	FY21	FY22	Average (FY20-22)
AU Small Finance Bank	1.7%	4.3%	2.0%	2.7%
Shriram City Union Finance	7.9%	6.4%	6.3%	6.9%
Aavas Financiers	0.5%	1.0%	1.0%	0.8%
Five Star Business	**1.4%**	**1.0%**	**1.1%**	**1.1%**
Home First Finance	1.0%	1.8%	2.3%	1.7%
Aptus Value Housing	0.7%	0.7%	1.2%	0.9%
Lending kart	2.2%	2.5%	3.9%	2.9%
Vistaar Finance	3.7%	3.3%	2.7%	3.2%

Veritas Finance	1.9%	2.7%	3.9%	2.8%
Aye Finance	2.1%	3.3%	3.3%	2.9%
Digikredit Finance	1.0%	3.5%	3.3%*	2.3%

Note: (*): 90+ DPD (including partner book as of December 2021, Source: Company reports, Rating Rationales, CRISIL Research

Trend of Net NPA of players

NNPA (%)	FY20	FY21	FY22	Average (FY20-22)
AU Small Finance Bank	0.8%	2.2%	0.5%	1.2%
Shriram City Union Finance	4.2%	3.1%	3.3%	3.5%
Aavas Financiers	0.3%	0.7%	0.8%	0.6%
Five Star Business	**1.1%**	**0.8%**	**0.7%**	**0.9%**
Home First Finance	0.8%	1.2%	1.8%	1.3%
Aptus Value Housing	0.6%	0.4%	0.9%	0.6%
Lending kart	1.0%	0.9%	1.6%	1.2%
Vistaar Finance	2.5%	2.2%	1.9%	2.2%
Veritas Finance	1.3%	1.4%	2.3%	1.7%
Aye Finance	0.1%	0.3%	1.4%	0.6%
Digikredit Finance	NA	NA	NA	NM

Source: Company reports, Rating Rationales, CRISIL Research

Five Star Business has one of the lowest restructured book in fiscal 2022

Among the compared peers, Five Star Business has one of the best total provisions to AUM ratio at 2.0% in fiscal 2022 amongst MSME focused lenders. Five Star Business also has one of the lowest restructured book at 1.5% in fiscal 2022. Home First Finance has the lowest restructured book at 0.7% in fiscal 2022.

Trend of Credit Cost of players

	Credit cost (%)				Stage 3 provisions to Stage 3 assets	Total provisions to Stage 3 assets	Total provision to AUM ratio	Restructured book (%)
	FY20	FY21	FY22	Avg. (FY20-22)	FY22	FY22	FY22	FY22
AU Small Finance Bank	0.8%	1.5%	0.6%	1.0%	NA	NA	NA	2.5%
Shriram City Union Finance	2.9%	2.6%	2.4%	2.6%	49.3%	99.6%	6.3%	0.9%
Aavas Financiers	0.2%	0.4%	0.2%	0.3%	23.1%	71.2%	0.6%	1.3%
Five Star Business	**1.5%**	**0.7%**	**0.8%**	**1.0%**	**34.9%**	**193.9%**	**2.0%**	**1.5%**
Home First Finance	0.6%	0.8%	0.5%	0.6%	24.9%	46.0%	0.9%	0.7%

Aptus Value Housing	0.1%	0.1%	0.6%	0.3%	25.3%	68.7%	0.7%	1.5%
Lending kart	6.0%	7.3%	16.1%	9.8%	59.1%	122.3%	2.9%	13.5%
Vistaar Finance	3.0%	2.4%	1.4%	2.2%	29.6%	73.0%	1.8%	4.3%
Veritas Finance	1.0%	2.0%	2.5%	1.8%	41.5%	64.2%	2.5%	3.6%
Aye Finance	4.0%	2.7%	5.5%	4.0%	61.8%	99.5%	3.6%	4.1%
Digikredit Finance	5.6%	11.2%	10.7%	9.2%	NA	NA	NA	8.0%

NA - Not available, Source: Company reports, CRISIL Research

Five Star Business has the second highest Capital Adequacy ratio amongst the peers as of March 2022

Five Star Business has the second highest Capital Adequacy Ratio of 75.2% after Aptus Value Housing (85.6%) among the compared peers as of March 2022. In terms of leverage, Five Star Business has the lowest leverage of 0.69 at end of fiscal 2022. This indicates better ability to leverage further leading to better RoEs.

Trend of Leverage and Capital Adequacy Ratio of players

	Leverage (times)				Capital adequacy ratio (%)			
	FY20	**FY21**	**FY22**	**Average (FY20-22)**	**FY20**	**FY21**	**FY22**	**Average (FY20-22)**
AU Small Finance Bank	2.36	1.12	0.80	1.43	22.0%	23.4%	21.0%	22.1%
Shriram City Union Finance	2.66	2.47	2.65	2.59	27.7%	28.6%	26.8%	27.7%
Aavas Financiers	2.55	2.64	2.84	2.68	55.9%	54.4%	51.9%	54.1%
Five Star Business	**1.22**	**1.48**	**0.69**	**1.13**	**52.9%**	**58.9%**	**75.2%**	**62.3%**
Home First Finance	2.67	2.21	2.20	2.36	49.0%	56.2%	58.6%	54.6%
Aptus Value Housing	1.18	1.27	0.93	1.13	82.5%	73.6%	85.6%	80.6%
Lending kart	2.18	2.20	2.99	2.46	36.2%	38.7%	25.9%	33.6%
Vistaar Finance	2.04	2.10	2.44	2.19	37.6%	36.5%	30.0%	34.7%
Veritas Finance	1.23	1.41	0.85	1.16	59.3%	50.7%	64.4%	58.1%
Aye Finance	2.81	1.76	2.15	2.24	31.0%	39.0%	36.0%	35.3%
Digikredit Finance	0.88	2.30	2.34	1.84	59.2%	28.7%	27.5%	38.5%

Note: For HFCs, the risk weights are lower than that for other NBFCs catering to business loans segment
Source: Company reports, CRISIL Research

Long-term credit rating for various players (At end of 29th Sept 2022)

Players	Long-term Credit Rating
AU Small Finance Bank	CRISIL AA+, CARE AA, IND AA
Shriram City Union Finance	CRISIL AA, ICRA AA, CARE AA, IND AA
Aavas Financiers	ICRA AA, CARE AA
Five Star Business	ICRA AAA(CE), CARE A+

Home First Finance	ICRA AA-, CARE AA-, IND AA-
Aptus Value Housing	ICRA AA-, CARE AA-
Lending kart	ICRA BBB+, IVR BBB+, IND BBB+
Vistaar Finance	ICRA A, IND A
Veritas Finance	CARE A
Aye Finance	ICRA BBB+, IND A-
Digikredit Finance	CRISIL BB+

Note: Ratings outstanding across credit ratings agencies as of September 2022
Source: Company reports, Rating reports, CRISIL Research

Borrowing mix of players (FY22)

Players	Debt Securities	From banks	From NBFC	Other Financial institutions	External commercial borrowings (ECB)	Borrowings under securitisation arrangement	Other parties
AU Small Finance Bank	-	8%	-	92%	-	-	-
Shriram City Union Finance	27%	49%	14%	-	-	9%	-
Aavas Financiers	23%	76%	-	1%	-	-	1%
Five Star Business	**39%**	**32%**	**6%**	**-**	**3%**	**19%**	**-**
Home First Finance	5%	58%	-	34%	-	-	2%
Aptus Value Housing	15%	47%	-	32%	-	4%	2%
Lending kart	68%	15%	-	14%	-	-	3%
Vistaar Finance	9%	67%	-	13%	11%	-	-
Veritas Finance	20%	69%	-	-	-	-	11%
Aye Finance	61%	7%	-	11%	14%	7%	1%
Digikredit Finance*	88%	12%	-	-	-	-	-

*Note: *FY21 data*
Source: Company reports, CRISIL Research

Five Star Business has the highest surplus in ALM in after 12 months bucket amongst the peer set as of March 2022

Five Star Business has a net surplus of Rs. 31.6 billion in *after 12 months* bucket in fiscal 2022. Aptus Value Housing has the next highest surplus at Rs. 26.1 billion in the same bucket at end of fiscal 2022. In the short term, Shriram City Union Finance has the highest surplus of Rs. 94.9 billion in *within 12 months* bucket at end of fiscal 2022. It is followed by Aavas Financiers (Rs. 18.3 billion) and Aye Finance (Rs. 6.2 billion).

ALM position of various peers

FY22 (Rs billion)	Assets		Liability		Net	
	Within 12 months	After 12 months	Within 12 months	After 12 months	Within 12 months	After 12 months
AU Small Finance Bank	NA	NA	NA	NA	NA	NA

Shriram City Union Finance	246.0	154.7	151.1	159.8	94.9	-5.1
Aavas Financiers	31.9	78.3	13.6	68.5	18.3	9.8
Five Star Business	**18.1**	**45.3**	**12.6**	**13.7**	**5.5**	**31.6**
Home First Finance	14.0	37.2	9.5	25.9	4.5	11.3
Aptus Value Housing	9.3	47.5	6.3	21.3	3.0	26.1
Lending kart	12.6	12.6	10.1	7.6	2.5	4.9
Vistaar Finance*	3.8	16.0	4.3	8.7	-0.5	7.3
Veritas Finance	9.0	17.4	6.1	6.2	2.9	11.2
Aye Finance	14.4	8.8	8.1	15.0	6.2	-6.5
Digikredit Finance	NA	NA	NA	NA	NA	NA

Note: (*) ALM analysis done as per data for fiscal 2021, Asset to liabilities ratio is calculated by dividing the percentage of assets maturing in the specified time period by percentage of liabilities maturing in the same time period, NA – Not available, ALM reported in the table above has been sourced by CRISIL Research from annual reports / public disclosures of the companies mentioned herein, including for Five Star Business. Investors should note that individual companies may compute ALM differently. The information contained in this table may deviate from Five Star Business' ALM data disclosed elsewhere in the DRHP and as such, investors are advised to read that ALM data together with the corresponding definitions used for computing the ALM therein, Source: Company reports, CRISIL Research

List of formulae

Parameters	Formula
RoA	Profit after tax / average of total assets on book
RoE	Profit after tax / average net worth
NIMs	(Net Interest Income) / average of total assets on book
Yield on advances	Interest earned on loans and advances / average of total advances on book
Cost to income	Operating expenses / (net interest income + other income+ fee income)
Cost of funds	Interest paid / (average of deposits and borrowings)
Credit cost	Provisions / average total assets on book
Net Profit Margin	Profit after tax/ total income

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